S. Hrg. 98-956

LEGISLATION AFFECTING OIL MERGER PROPOSALS

HEARING

BEFORE THE

SUBCOMMITTEE ON
ENERGY AND MINERAL RESOURCES

OF THE

COMMITTEE ON
ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

SECOND SESSION

ON

S. 2362

A BILL TO AMEND THE MINERAL LANDS LEASING ACT OF 1920, AND FOR OTHER PURPOSES

APRIL 10, 1984

Printed for the use of the
Committee on Energy and Natural Resources

U.S. GOVERNMENT PRINTING OFFICE
37-154 O
WASHINGTON : 1984

S311-53

COMMITTEE ON ENERGY AND NATURAL RESOURCES

JAMES A. McCLURE, Idaho, *Chairman*

MARK O. HATFIELD, Oregon
LOWELL P. WEICKER, Jr., Connecticut
PETE V. DOMENICI, New Mexico
MALCOLM WALLOP, Wyoming
JOHN W. WARNER, Virginia
FRANK H. MURKOWSKI, Alaska
DON NICKLES, Oklahoma
CHIC HECHT, Nevada
JOHN H. CHAFEE, Rhode Island
JOHN HEINZ, Pennsylvania
DANIEL J. EVANS, Washington

J. BENNETT JOHNSTON, Louisiana
DALE BUMPERS, Arkansas
WENDELL H. FORD, Kentucky
HOWARD M. METZENBAUM, Ohio
SPARK M. MATSUNAGA, Hawaii
JOHN MELCHER, Montana
PAUL E. TSONGAS, Massachusetts
BILL BRADLEY, New Jersey
CARL LEVIN, Michigan

Michael D. Hathaway, *Staff Director*
Charles A. Trabandt, *Chief Counsel*
D. Michael Harvey, *Chief Counsel for the Minority*

Subcommittee on Energy and Mineral Resources

JOHN W. WARNER, Virginia, *Chairman*

JOHN HEINZ, Pennsylvania
MALCOLM WALLOP, Wyoming
FRANK H. MURKOWSKI, Alaska
CHIC HECHT, Nevada

JOHN MELCHER, Montana
DALE BUMPERS, Arkansas
SPARK M. MATSUNAGA, Hawaii
BILL BRADLEY, New Jersey

James A. McClure and J. Bennett Johnston are Ex Officio Members of the Subcommittee
Roger Sindelar, Counsel

CONTENTS

Page
S. 2362 4

STATEMENTS

Batten, David C., managing director, First Boston Corp 428
Blum, Jack A., general counsel, Independent Gasoline Marketers Council 499
Boggs, Hon. Danny J., Deputy Secretary, Department of Energy 20
Chisholm, Phillip R., executive vice president, National Oil Jobbers Council 349
Cooper, Dr. Mark N., director of energy, Consumer Federation of America 441
Cooper, Larry Napoleon, chief executive officer, Project 76, an American Affair, Inc 482
Copulos, Milton A., senior analyst, Energy and Natural Resources, the Heritage Foundation 390
Derr, Kenneth T., president, Chevron, U.S.A. Inc., and vice president and director, Standard Oil Co. of California 227
Ginsburg, Hon. Douglas H., Deputy Assistant Attorney General, Antitrust Division, Department of Justice 53
Griles, Hon. J. Steven, Deputy Assistant Secretary, Land and Minerals Management, Department of the Interior 50
Harmon, William R., general counsel, Morgan Stanley & Co., Inc., accompanied by Simon P. Orme, principal, Mergers Department, and John D. Paulus, chief economist 512
Hecht, Hon. Chic, a U.S. Senator from the State of Nevada 17
Heinz, Hon. John, a U.S. Senator from the State of Pennsylvania 17
Heizer, James, executive director, Virginia Gasoline Retailers Association, on behalf of the Service Station Dealers of America 339
Huber, Hon. John J., Director, Division of Corporation Finance, Securities and Exchange Commission 87
Jones, Jon Rex, president, Jones Exploration Co., and president, Independent Petroleum Association of America 311
Kirschner, Michael S., chief executive officer, Kirschner Bros. Oil Co., on behalf of the Society of Independent Gasoline Marketers of America 475
Lichtblau, John H., president, Petroleum Industry Research Foundation, Inc 361
McClure, Hon. James A., a U.S. Senator from the State of Idaho 7
Melcher, Hon. John, a U.S. Senator from the State of Montana 19
Murdy, James L., executive vice president, Gulf Corp 255
Muris, Hon. Timonthy J., Director, Bureau of Competition, Federal Trade Commission 67
Murkowski, Hon. Frank H., a U.S. Senator from the State of Alaska 12
Murphy, Charles H., chairman, Murphy Oil Corp 298
Nickles, Hon. Don, a U.S. Senator from the State of Oklahoma 333
Pearlman, Hon. Ronald A., Deputy Assistant Secretary (Tax Policy), Department of the Treasury 40
Pickens, T. Boone, Jr., president and chairman of the board, Mesa Petroleum Co 278
Robinson, Dr. Thomas R., senior vice president, Merrill Lynch Economics 518
Rothchild, Edwin, assistant director, Citizen/Labor Energy Coalition 397
Schuler, G. Henry M., Dewey F. Bartlett chair in energy security studies, Center for Strategic and International Studies, Georgetown University 376
Story, Joseph C., senior economist, Middle East Economic Services, Wharton Econometric Forecasting Associates 509
Tavoulareas, William P., president, Mobil Corp 261
Wallop, Hon. Malcolm, a U.S. Senator from the State of Wyoming 16
Warner, Hon. John W., a U.S. Senator from the State of Virginia 1

APPENDIX

Additional material submitted for the record 527

LEGISLATION AFFECTING OIL MERGER PROPOSALS

TUESDAY, APRIL 10, 1984

U.S. Senate,
Subcommittee on Energy and Mineral Resources,
Committee on Energy and Natural Resources,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:40 a.m., in room SD-366, Dirksen Office Building, Hon. John W. Warner, presiding.

Present: Senators Warner, McClure, Wallop, Murkowski, Nickles, Hecht, Heinz, and Melcher.

Also present: Roger Sindelar, counsel; Elizabeth Moler and James T. Bruce, counsels for the minority.

OPENING STATEMENT OF HON. JOHN W. WARNER, A U.S. SENATOR FROM THE STATE OF VIRGINIA

Senator Warner. Today the Subcommittee on Energy and Mineral Resources meets to consider legislation which calls for a study of the impact of oil mergers on America's energy policy. Chairman McClure and I scheduled these hearings as expeditiously as possible because of the vital importance of this issue.

Senate debate on the question of oil mergers covered a wide range of complex legal and social issues ranging from antitrust law to interest rates to the costs and availability of energy to consumers.

The initial Senate debate on oil mergers culminated in the passage of a "sense of the Senate amendment" calling for a study to assess the impact of oil mergers on our national interest by the appropriate Senate committees with the committees reporting their findings to the Senate no later than July 1, 1984. This hearing will contribute to those findings.

In the interest of time, I will waive further reading of my opening statement and defer to the chairman.

[The prepared statement of Senator Warner and the text of S. 2362 follow:]

OPENING STATEMENT OF SENATOR JOHN W. WARNER
SENATE SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES

LEGISLATIVE HEARINGS - S. 2362
SD-366
APRIL 10, 1984
9:30 A.M.

TODAY, THE SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES MEETS TO CONSIDER LEGISLATION WHICH CALLS FOR A STUDY OF THE IMPACT OF OIL MERGERS ON AMERICA'S ENERGY POLICY. CHAIRMAN MCCLURE AND I SCHEDULED THESE HEARINGS AS EXPEDITIOUSLY AS POSSIBLE BECAUSE OF THE VITAL IMPORTANCE OF THIS ISSUE.

SENATE DEBATE ON THE QUESTION OF OIL MERGERS COVERED A WIDE RANGE OF COMPLEX LEGAL AND SOCIAL ISSUES RANGING FROM ANTITRUST LAW TO INTEREST RATES TO THE COSTS AND AVAILABILITY OF ENERGY TO CONSUMERS.

THE INITIAL SENATE DEBATE ON OIL MERGERS CULMINATED IN THE PASSAGE OF A "SENSE OF THE SENATE AMENDMENT" CALLING FOR A STUDY TO ASSESS THE IMPACT OF OIL MERGERS ON OUR NATIONAL INTEREST BY THE APPROPRIATE SENATE COMMITTEES WITH THE COMMITTEES REPORTING THEIR FINDINGS TO THE SENATE NO LATER THAN JULY 1, 1984. THIS HEARING WILL CONTRIBUTE TO THOSE FINDINGS.

RECENT HEIGHTENING OF TENSIONS IN THE MIDDLE EAST GRAPHICALLY POINTS OUT THAT AMERICA'S ENERGY DESTINY IS STILL PRECARIOUSLY INTERTWINED, EITHER DIRECTLY OR INDIRECTLY THROUGH ENERGY SUPPLY AGREEMENTS, WITH THE FORTUNES OF MIDDLE EAST OIL.

(MORE)

AMERICA'S NATIONAL SECURITY IS ONLY AS STRONG AS ITS ENERGY SECURITY. TO CONTROL OUR OWN DESTINY WE MUST STRENGTHEN AND IMPROVE OUR OWN ENERGY DESTINY. TOWARDS THIS END, I HAVE BEEN A STRONG SUPPORTER OF EFFORTS TO STIMULATE THE PRODUCTION AND UTILIZATION OF AMERICA'S DOMESTIC ENERGY RESOURCES.

THE OIL MERGER ACTIVITY OF THE PAST FEW WEEKS HAS BROUGHT ABOUT A REEXAMINATION OF AMERICA'S ENERGY POLICY. QUESTIONS HAVE BEEN RAISED AS TO WHETHER MERGER ACTIVITY HAS HELPED OR HINDERED AMERICA'S MOVEMENT TOWARDS ENERGY INDEPENDENCE.

WHEN EXAMINING OIL MERGERS IN GENERAL, THE COMMITTEE MUST SCRUTINIZE THEIR IMPACT ON OUR:
(1) NATIONAL SECURITY (2) FEDERAL MINERAL LEASING PROGRAM (3) ENERGY INDEPENDENCE (4) ENERGY SUPPLY (5) ENERGY EXPLORATION (6) ENERGY RESEARCH AND DEVELOPMENT (7) ENERGY PRODUCTS (8) ENERGY COSTS (9) CAPITAL MARKETS AND INTEREST RATES.

I WELCOME THE WITNESSES AND LOOK FORWARD TO THEIR TESTIMONY.

###

II

98TH CONGRESS
2D SESSION

S. 2362

To amend the Mineral Lands Leasing Act of 1920, and for other purposes.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 28 (legislative day, FEBRUARY 27), 1984

Mr. JOHNSTON introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

To amend the Mineral Lands Leasing Act of 1920, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Mineral Lands Leasing Act of 1920, as amended (30 U.S.C. 181 et seq.), is further amended by inserting a new section as follows:

"LIMITATION ON AUTHORITY WITH RESPECT TO MERGER PARTIES

"SEC. 43. (a) GENERAL PROHIBITION.—Notwithstanding any other provision of this Act, the Secretary is prohibited from issuing any lease or granting any right-of-way under the provisions of this Act to any person who is subject to the provisions of this section.

"(b) APPLICABILITY.—The provisions of this section shall apply to any person—

"(1) who is a party to a merger consummated after February 28, 1984, and prior to six months following the date of enactment of this section, and

"(2) who is a substantial energy reserve holder.

"(c) DEFINITIONS.—For purposes of this section, the term—

"(1) 'merger' includes mergers, consolidations, or acquisitions whereby one person acquires control or a majority of the assets of any other person;

"(2) 'substantial energy reserve holder' means any person who, individually or together with his affiliates, owns or has an interest in, ten million barrels or more of proved reserves of crude oil, natural gas liquids equivalents, or natural gas equivalents.".

SEC. 2. The Outer Continental Shelf Lands Act, as amended (43 U.S.C. 1331–55), is further amended by inserting a new section as follows:

"LIMITATION ON AUTHORITY WITH RESPECT TO MERGER PARTIES

"SEC. 31. (a) GENERAL PROHIBITION.—Notwithstanding any other provision of this Act, the Secretary is prohibited from issuing any lease or granting any right-of-way under the provisions of this Act to any person who is subject to the provisions of this section.

"(b) APPLICABILITY.—The provisions of this section shall apply to any person—

"(1) who is a party to a merger consummated after February 27, 1984, and prior to six months following the date of enactment of this section, and

"(2) who is a substantial energy reserve holder.

"(c) For purposes of this section, the term—

"(1) 'merger' includes mergers, consolidations, or acquisitions whereby one person acquires control or a majority of the assets of any other person;

"(2) 'substantial energy reserve holder' means any person who, individually or together with his affiliates, owns or has an interest in, ten million barrels or more of proved reserves of crude oil, natural gas liquids equivalents, or natural gas equivalents.".

○

STATEMENT OF HON. JAMES A. McCLURE, A U.S. SENATOR FROM THE STATE OF IDAHO

The CHAIRMAN. Thank you, Mr. Chairman. I want to express my appreciation as chairman of the full committee to you for scheduling this hearing on the important issue of an oil merger moratorium and pending legislative proposals imposing such a moratorium. At the time this hearing was originally scheduled, the Senate had not acted substantively on any of the pending proposals.

Since that time, the Senate has adopted in the fiscal year 1984 urgent supplemental appropriations bill, H.J. Res. 492, the amendment offered by myself, Senator Baker, Senator Dole and other Members. The amendment expressed the sense of the Senate that in lieu of taking any action at this time to impose a complete moratorium on oil mergers, the Senate defers consideration of the issue until full hearings have been completed by the Energy, Finance and Judiciary Committees on the issue and a study of the impact of such mergers on our national interests has been completed and reported to the Senate, no later than July 1, 1984.

The amendment was adopted as a substitute for an 11-month oil merger moratorium amendment offered by Senators Johnston, Metzenbaum, Rudman, and others. Consequently, this hearing today is highly relevant and timely to the action of the Senate, as expressed in the sense of the Senate calling for full hearings in this committee.

Mr. Chairman, I ask unanimous consent that the full text of the amendment contained in section 105 of H.J. Res. 492 be placed in the record.

Mr. Chairman, I opposed the imposition of an 11-month oil merger moratorium for a number of reasons, which I trust will receive thoughtful consideration in the hearing today. First, the Senate was being asked, without a single day of legislative hearings, to impose an almost 1 full year moratorium. The sense of the Senate provision adopted by the Senate provides the necessary time to develop a full and complete record upon which to consider any necessary legislative proposal. This hearing is an important step in that process.

Mr. Chairman, in interest of time, I ask that the balance of my statement be placed in the record.

Senator WARNER. Without objection.

[The prepared statement of Senator McClure and section 105 of H.J. Res. 492 follow:]

OPENING STATEMENT OF SENATOR JAMES A. McCLURE
FOR THE SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
HEARING ON S. 2362 -- APRIL 10, 1984

MR. CHAIRMAN, I WANT TO EXPRESS MY APPRECIATION AS CHAIRMAN OF THE FULL COMMITTEE TO YOU FOR SCHEDULING THIS HEARING ON THE IMPORTANT ISSUE OF AN OIL-MERGER MORATORIUM AND PENDING LEGISLATIVE PROPOSALS IMPOSING SUCH A MORATORIUM. AT THE TIME THIS HEARING WAS ORIGINALLY SCHEDULED, THE SENATE HAD NOT ACTED SUBSTANTIVELY ON ANY OF THE PENDING PROPOSALS.

SINCE THAT TIME, THE SENATE HAS ADOPTED IN THE FISCAL YEAR 1984 URGENT SUPPLEMENTAL APPROPRIATIONS BILL, H.J.RES. 492, THE AMENDMENT OFFERED BY MYSELF, SENATOR BAKER, SENATOR DOLE AND OTHER MEMBERS. THE AMENDMENT EXPRESSED THE SENSE OF THE SENATE "THAT IN LIEU OF TAKING ANY ACTION AT THIS TIME TO IMPOSE A COMPLETE MORATORIUM ON OIL MERGERS, THE SENATE DEFERS CONSIDERATION OF THE ISSUE UNTIL FULL HEARINGS HAVE BEEN COMPLETED BY THE ENERGY, FINANCE AND JUDICIARY COMMITTEES ON THE ISSUE AND A STUDY OF THE IMPACT OF SUCH MERGERS ON OUR NATIONAL INTERESTS HAS BEEN COMPLETED AND REPORTED TO THE SENATE, NO LATER THAN JULY 1, 1984." THE AMENDMENT WAS ADOPTED AS A SUBSTITUTE FOR AN 11 MONTH OIL MERGER MORATORIUM AMENDMENT OFFERED BY SENATORS JOHNSTON, METZENBAUM, RUDMAN AND OTHERS. CONSEQUENTLY, THIS HEARING TODAY IS HIGHLY RELEVANT AND TIMELY TO THE ACTION OF THE SENATE, AS EXPRESSED IN THE SENSE OF THE SENATE CALLING FOR FULL HEARINGS IN THIS COMMITTEE. MR. CHAIRMAN, I ASK UNANIMOUS CONSENT THAT THE FULL TEXT OF THE AMENDMENT CONTAINED IN SECTION 105 OF H.J.RES. 492 BE PLACED IN THE RECORD AT THIS POINT. (INSERT IN RECORD WITH TEXT)

MR. CHAIRMAN, I OPPOSED THE IMPOSITION OF AN ELEVEN MONTH OIL MERGER MORATORIUM FOR A NUMBER OF REASONS, WHICH I TRUST WILL RECEIVE THOUGHTFUL CONSIDERATION IN THE HEARING TODAY. FIRST, THE SENATE WAS BEING ASKED, WITHOUT A SINGLE DAY OF LEGISLATIVE HEARINGS, TO IMPOSE AN ALMOST ONE FULL YEAR MORATORIUM. THE SENSE OF THE SENATE PROVISION ADOPTED BY THE SENATE PROVIDES THE NECESSARY TIME TO DEVELOP A FULL AND COMPLETE RECORD UPON WHICH TO CONSIDER ANY NECESSARY LEGISLATIVE PROPOSAL. THIS HEARING IS AN IMPORTANT STEP IN THAT PROCESS.

SECOND, I CONCLUDED ON THE BASIS OF THE RECORD THEN AVAILABLE, THAT THE MORATORIUM AMENDMENT WAS NOT JUSTIFIED ON THE BASIS OF ANY available facts relating to antitrust, securities law, or energy policy considerations. Let me briefly summarize my findings with regard to each of those policies.

Antitrust. Existing law is adequate to protect the American public from any negative competitive impacts resulting from oil mergers, and the FTC enforcement of the law during the Reagan Administration has been vigorous and effective, including successful opposition to two proposed oil company mergers and substantial divestitures in Texaco-Getty. Senator Johnston agreed in a Dear Colleague letter that this conclusion is "probably correct."

Securities Law. The SEC, based on the Report of Recommendations of its prestigious 1983 Advisory Committee on Tender Offers, two weeks ago proposed legislative and regulatory amendments to implement sweeping reforms of the securities regulation treatment of tender offers, a key factor of concern in the oil company mergers.

Energy Policy. Currently available factual data demonstrates that there generally is *not* a decrease in exploraton activitiy after a merger, largely as a function of factors other than those related to the merger. In fact, in five of six recent oil company mergers, exploration activity actually *increased* in the post-merger period. Also, all of the so-called "targeted" oil companies constitute an aggregate of only 7% of domestic reserves.

Third, I concluded the amendment was likely, however, to cause potentially widespread chaos and dislocations in this nation's securities markets for royalty trusts and oil corporations' common stocks and other securities. Such chaos and dislocation, while clearly unintended by the sponsors, would have resulted from the impact of largely ambiguous terms and virtually unsettled concepts drawn from securities law to achieve an antitrust moratorium. Securities law is a highly complex and finely developed body of law intended to provide adequate protection to investors and predictable operation of the securities market.

The amendment could have rendered the operation of the markets for oil company securities unpredictable and the protections unsure, at best. Thus, it would discourage investment in that

SECTOR AND DEPRESS THE VALUE OF SECURITIES IN THAT SECTOR TO THE GREAT DETRIMENT OF CURRENT INVESTORS, SUCH AS INSURANCE COMPANIES, PENSION FUNDS AND INDIVIDUAL INVESTORS. SUCH A RESULT WOULD ALSO NEGATIVELY AFFECT THE AMOUNT OF MONEY AVAILABLE FOR EXPLORATION AND DRILLING, PRECISELY THE OPPOSITE RESULT THE SUPPORTERS SOUGHT TO ACHIEVE.

PERHAPS, FTC CHAIRMAN JAMES MILLER EXPRESSED MY CONCERNS WITH REGARD TO MORATORIUM LEGISLATION BEST IN HIS MARCH 20TH LETTER. HE STATED, "THAT BY ERECTING A TEMPORARY, ARTIFICIAL BARRIER TO NORMAL MARKET OPERATIONS, SUCH LEGISLATION IS LIKELY TO HAVE THE UNDESIRABLE AND UNFAIR EFFECT OF DISRUPTING CAPITAL MARKETS AND IMPINGING UPON THE RIGHTS OF THOUSANDS OF COMPANY SHAREHOLDERS WITH NO REAL OFFSETTING BENEFITS IN THE PRODUCTION OF ENERGY." MR. CHAIRMAN, I HOPE THAT THESE HEARINGS WILL CAREFULLY EXAMINE ALL OF THE MANY ISSUES RAISED BY THE PENDING PROPOSALS AND DEVELOP THE FULL AND COMPLETE RECORD FOR OUR REVIEW. TO THAT END, I WOULD ASK UNANIMOUS CONSENT THAT MY DEAR COLLEAGUE OF MARCH 27, 1984, ON THIS SUBJECT, WITH AN ENCLOSURE AND ATTACHMENTS, BE PLACED IN THE RECORD.

LET ME CONCLUDE BY AGAIN COMMENDING THE SUBCOMMITTEE CHAIRMAN FOR PROCEEDING WITH THIS HEARING AND THE IMPRESSIVE WITNESS LIST IN RESPONSE TO THE DIRECTIONS OF THE SENATE ON THIS CRITICAL NATIONAL ISSUE.

(26) *Sec. 105. (a) Study.—The recent proliferation of mergers involving oil companies in this country and the potential implication of such mergers upon our Nation's policy with respect to energy, tax, and antitrust laws, present serious issues that need to be carefully considered by the Senate; and, pending further study, it is unclear whether a complete moratorium on such mergers is in our Nation's interest; and, the Committee on the Judiciary has only recently completed a hearing on the oil merger issue and the Committee on Finance has scheduled a hearing on the oil merger issue for April 5, 1984, and the Committee on Energy and Natural Resources has scheduled a hearing for April 10, 1984.*

(b) It is the sense of the Senate that in lieu of taking any action at this time to impose a complete moratorium on oil mergers, the Senate defers consideration of the issue until full hearings have been completed by the Committees on Energy and Natural Resources, Finance, and the Judiciary on the issue and a study of the impact of such mergers on our national interests has been completed and reported to the Senate no later than July 1, 1984. It is further the sense of the Senate that any changes recommended by the Committees on Energy and Natural Resources, Finance, and the Judiciary, if enacted, be made effective as of March 27, 1984.

STATEMENT OF HON. FRANK H. MURKOWSKI, A U.S. SENATOR FROM THE STATE OF ALASKA

Senator MURKOWSKI. Thank you very much, Senator Warner. I appreciate the opportunity to make a statement this morning. I think there have been a number of counterclaims and claims surrounding this particular issue and the question of new oil reserves is focused on Wall Street rather than the energy frontiers.

I think we have to reflect on just where these new energy frontiers are. Our future supplies of domestic oil and gas are going to have to come from the Nation's Outer Continental Shelf. However, we have virtually eliminated most of that available area, and the remaining area is my State of Alaska.

Unfortunately it may be far less expensive to acquire new reserves by buying a smaller company rather than seeking those reserves in Alaska or somewhere else on the Continental Shelf. Mr. Chairman, I feel that Congress must share the blame for that fact. I believe that the merger fever that we have seen in the last several months is a result of Congress' failure to encourage exploration in the Continental Shelf area.

I think what we have done in passing these seemingly endless moratoriums on these areas is to eliminate the areas that should be made available and we have used the leasing moratoriums to deny the industry the opportunity to look for oil and gas in promising areas off California, Florida, and New England. Yet, many of us in the Senate who supported these leasing moratoria are today chastising industry for failing to look in the frontier areas.

Perhaps the greatest absurdity is that we have stated our willingness to use military force in keeping the Straits of Hormuz open for the movement of Mideast oil. Less than 3 percent of our oil moves through that strait. How can we be willing to risk American lives for less than 3 percent of our oil supply, while at the same time we are closing off promising frontier areas in our own backyard?

Let's not piously point to the mergers as being inconsistent with the interests of the consumer, unless we recognize the fact that this Congress has acted against the interest of the consumer with the imposition of these OCS leasing moritoria which cost this Nation an estimated 1.35 billion barrels of oil and as much as $1.5 billion each year in lost Federal revenues.

Mr. Chairman, we are back to importing a third of our oil. Our proven domestic reserves fell by a third during the 1970's. Eighty percent of last year's $70 billion trade deficit was due to imported oil. This committee I would hope would make one recommendation to the Senate and that is the repeal of the OCS moratoria which was imposed late last year.

If we can't repeal the leasing moritoria, then we ought to streamline the cumbersome process which industry must face when it attempts to explore for oil and gas.

One only has to look at the committee list of some 75 Federal plans, permits and approvals that an oil company must now face to obtain drilling offshore to realize the time it takes to receive approval for oil and gas drilling. Seventeen of these are major Federal permits.

It takes a year to acquire the necessary permits to drill a new onshore well in the Arctic area of Alaska. It takes as much as 550 days for a 404 permit to be issued by the Army Corps of Engineers.

This burdensome overregulation which has resulted as a consequence of these statutes can be streamlined while maintaining the protections we want to retain. I intend to ask, Mr. Chairman, the General Accounting Office to undertake a comprehensive study to develop a range of the legislative options Congress should pursue if we want to streamline the permitting processes which are brought to bear on industry as it seeks to explore our energy frontiers.

It is clear that the constraints to frontier oil and gas exploration and development run absolutely counter to our often stated goal of achieving a greater degree of energy independence. Because this committee has not yet chosen to address these questions appropriately in OCS oversight hearings, I am raising these points now and will continue to raise them in the context of this issue or any other relevant issue before the committee or any one of its subcommittees.

I ask that my entire statement be entered in the record.

Senator **Warner**. Without objection.

[The prepared statement of Senator Murkowski follows:]

STATEMENT OF SENATOR FRANK H. MURKOWSKI
BEFORE THE
SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

APRIL 10, 1984

A number of significant oil company mergers have sparked a good deal of debate in recent months. As a consequence of action taken by the full Senate, that debate has moved to the Energy and Natural Resources Committee, along with the Committees on Finance and the Judiciary. The Senate is awaiting our guidance and leadership on this issue. I believe we can make some important contributions.

A number of our colleagues have expressed their disapproval over the current wave of oil company takeovers, arguing that the search for new oil reserves has focused on Wall Street rather than new energy frontiers.

Just where are these new energy frontiers? Our future supplies of domestic oil and gas will have to come from the nation's Outer Continental Shelf and Arctic Alaska. The industry is exploring these areas -- but only to the limited extent we are allowing them to.

Unfortunately, it may indeed be far less expensive to acquire new reserves by buying a smaller company rather than seeking those reserves in Arctic Alaska or the Outer Continental Shelf, and Congress must share the blame for that fact. I believe we are partly to blame for the "merger fever" we have seen in recent months.

We have done a great deal to make exploration and development in frontier areas more cumbersome, difficult and expensive than it needs to be.

We have imposed moritoria on OCS lease sales.

We have passed the legislation creating the seemingly endless permitting processes which industry faces when it searches for oil and gas in frontier areas.

I find it unbelievable that we have used leasing moritoria to deny industry the opportunity to look for oil and gas in promising areas off California, Florida and New England, yet many in the Senate who supported these leasing moritoria are today chastising industry for failing to look in the frontier areas!

Perhaps the greatest absurdity of all, Mr. Chairman, is that we have stated our willingness to use military force in keeping the Strait of Hormuz open for the movement of Mideast oil. Less than 3% of our oil moves through that Strait. How can we be willing to risk American lives for less than 3% of our oil supply, while at the same time we close off promising frontier areas in our own backyard to exploration? Our priorities are perverted, Mr. Chairman.

So let's not piously point to the mergers as being inconsistent with the interests of the consumer, unless we recognize the fact that this Congress has acted against the interest of the consumer with the imposition of these OCS leasing moritoria which cost this nation an estimated 1.35 billion barrels of oil, and $1.5 billion dollars each year in lost Federal revenues, taxes, production, jobs, and increased dependence on foreign oil.

We are back to importing a third of oil. Our proven domestic reserves fell by a third during the 1970's. 80% of of last year's $70 billion dollar trade deficit was due to imported oil. These facts have led me to one conclusion: If this Committee makes but one recommendation to the Senate with respect to oil mergers and their impact on exploration and development, we should recommend the repeal of the OCS moritoria we imposed late last year. The inconsistency of these moritoria with the arguments I heard in favor of anti-merger legislation is self evident. We have created a good many of the circumstances which have created the climate resulting in the so called "merger fever." We need to face up to that fact.

If we can't repeal the leasing moritoria then we ought to streamline the cumbersome permitting processes which industry must face when it attempts to explore for oil and gas.

I have here a list of the roughly 75 Federal plans, permits and approvals that an oil company must face prior to drilling offshore. Seventeen of these are major Federal permits.

These plans, permits and approvals are a result of the OCS Lands Act, the Coastal Zone Management Act, the National Environmental Policy Act, the Federal Water Pollution Control Act, the Clean Air Act, and the Endangered Species Act, and twenty-nine other Federal statutes.

Of course, it is often just as difficult to move throughout the regulatory morass facing an onshore operator working in a frontier area. On average, it takes a year to acquire the necessary permits to drill a new onshore well in Arctic Alaska. I have case studies in my files where a single permit -- the section 404 permit issued by the Army Corps of Engineers -- has taken 550 days to receive.

I am not suggesting that we should repeal the Clean Water Act, the National Environmental Policy Act, or any of the other 33 statutes which have resulted in the regulation of frontier oil and gas exploration. We enacted these laws to protect the environment, maintain the health and safety of workers and promote the general welfare. I am certain that the burdensome over-regulation which has resulted as a consequence of these statutes can be streamlined while maintaining the protections we want to retain. I am asking the General Accounting Office to undertake a comprehensive study to develop a range of the legislative options Congress should pursue if we want to streamline the permitting processes which are brought to bear on industry as it seeks to explore our energy frontiers.

Regardless of one's position on the impact oil company mergers on exploration and development, it is clear that the constraints to frontier oil and gas exploration -- whether they are in the form of OCS leasing moritoria or burdensome and unnecessary regulations -- run absolutely counter to our often stated goal of achieving a greater degree of energy independence. Because this Committee has not yet chosen to address these questions properly in OCS oversight hearings, I am raising these points now and will continue to raise them in the context of this issue or any other relevant issue before the Committee or any one of its Subcommittees.

STATEMENT OF HON. MALCOLM WALLOP, A U.S. SENATOR FROM THE STATE OF WYOMING

Senator WALLOP. Mr. Chairman, I thank you for chairing the hearing and organizing them. We had a hearing in the Finance Committee in my Subcommittee on Energy and Agriculture on this subject. The question I asked then and the question which I think must be answered now before there is any kind of flamboyant action on the part of the Congress is what, if any, is the threat from oil mergers?

To date, I have had no answer to that. I have had a lot of smoke raised, a lot of people creating ghosts and phantoms and it is very difficult to argue with a phantom, but when it comes down to demonstrating either through history or through any kind of solid predictability that a threat exists, it has not been shown.

We discovered in the Finance Committee that there were no tax driven reasons for such mergers. In other words, mergers for the sake of tax purposes were not taking place. Because of the complexity of these matters the hearing was to see what effect the tax laws, which allowed such mergers, would have on the economy. We discovered that there was no effect on interest rates. There was no threat of concentration within the industry that could possibly bring it to the level of concentration of autos or steel or anything close to that.

What we did discover, as well, was that Congress' flamboyance on the issue has taken several billions of dollars from the stockholders of energy companies. These energy company stocks have declined 4.7 percent over and above the market performance since Congress has been looking at the oil merger question causing a reduction of billions of dollars from the value of the companies stocks.

We have taken money from school teachers, from pension funds, from union funds and from individual stockholders, just because we have raised a threat which nobody has been able to define or substantiate its existence.

What has happened to energy exploration and other things has been ably described by Senator Murkowski. We are doing more to make these events unattractive by the actions of Congress than anything else, by the moratorium, by the withdrawal of public lands, by all kinds of events.

The thing that is important here, having discovered in the Finance Committee that there seems to be no threats of concentration, no tax driven reason for oil mergers, no threats of interest rate increases, now, is that we have to determine whether or not there is, in fact, a threat, which can be described and plausibly substantiated to consumers or to energy production.

I suspect the answer to that, too, will be none. Thank you.

Senator **WARNER**. Senator Hecht.

STATEMENT OF HON. CHIC HECHT, A U.S. SENATOR FROM THE STATE OF NEVADA

Senator **HECHT**. Thank you, Mr. Chairman. As a former businessman, I come to this hearing with the attitude that oil company mergers are not by definition bad. This activity goes to the heart of our free enterprise system.

Therefore, I think the burden of proof should be on the Government to make their case that oil company mergers are in essence bad, if they are. I think this takes time and I am happy to have this hearing today.

Thank you.

Senator **WARNER**. Senator Heinz.

STATEMENT OF HON. JOHN HEINZ, A U.S. SENATOR FROM THE STATE OF PENNSYLVANIA

Senator **HEINZ**. Mr. Chairman, first, let me commend you and Senator McClure, for calling these hearings. I was among those who, asked that the Energy Committee convene such a hearing, partly because the oil mergers taking place affect in very real terms the people in my home State of Pennsylvania. For example, the Socal-Gulf merger is likely to have the effect of putting 2,000 people out of work in the Gulf building in Pittsburgh.

This massive unemployment comes as no surprise to me at this point, because when I met with Mr. Keller, the chairman of Socal, and Jim Lee, I guess soon to be the former chairman of Gulf, they confirmed that their plans were to phase out all of Gulf's operations in its headquarters, which is currently located in Pittsburgh.

Second, there are several hundred Gulf dealers in the State of Pennsylvania. Each of them employs a large number of people, 10 to 20 to 30 people per filling station, and according to reports many of these marketing operations are also going to be phased out, but the status of those stations, service stations and their employees is subject to speculation.

Beyond those personal concerns I have, I think there are three reasons, Mr. Chairman, for serious study by this committee. Particularly, I think we need to ask in three ways how this way of mergers, which really goes back 2 years and includes some $63 billion in finance money, really affects the potential for the additional exploration, discovery and production of new reserves.

First, I think we have to look at whether there in fact does exist what I believe is the substantial possibility that the very large amounts of capital needed to consummate these mergers, $13 billion of borrowed money in the case of the Socal-Gulf merger, will have the effect of reducing the amount of money that oil companies that do merge commit to exploration and development for new reserves. I hope that our witnesses will be explicit on that point, and that they will tell us how the additional borrowing and the debt service that the mergers requires, can be deducted as a cost of doing business, It would seem to me that those interest payments do constitute, a substantial drain on cash flow that might otherwise be committed to development of new reserves.

Second is whether this multimillion dollar wave of mergers has any effect on interest rate levels generally. One of our colleagues stated a moment ago that the Finance Committee hearings had established this. I think that is beauty being in the mind of the beholder. One of the Wall Street experts conceded that he thought that these mergers had been a factor in driving up interest rates and was a factor in the Federal Reserve to increase the discount rate by half a point.

What does that have to do with exploration in production? The answer, independents have to borrow most of their money. They have to finance most of their wells. It may be that large oil companies merging are relatively insensitive as to whether they have to pay 11 or 11.5 percent for the money they borrow to consummate a merger, but the independents find that that increase in cost to them is a very significant increase in the cost of doing business, in raising the cost of their capital, most of which they have to finance from either direct bank borrowing to them or to their codrillers or to other even more expensive means.

Finally, Mr. Chairman, and I appreciate the time of the committee in considering these matters, there is the issue of whether the tax breaks that we have, I think for good reason, over the years accorded the oil industry, in particular the tangible drilling costs in both percentage and cost depletion, have in a sense been misappropriated. The question is whether these tax incentives which were instituted for the purpose of giving monies to companies to go out and look for and drill for and find more oil, have served their purpose or whether the substantial tax benefits, these incentives provide the substantial taxes that have not had to have been paid, because of those tax rates—have enabled oil companies to have much cleaner balance sheets, be in a much stronger position financially and, therefore, to be able to go out and borrow $10 to $12 to $13 billion and consummate these mergers.

So I would suggest in closing, Mr. Chairman, that a question that the committee should address of its expert witnesses is whether these mergers would have been as attractive and whether they would have been as feasible had not the Congress granted the oil industry intangible costs and the oil depletion allowance in both of its forums. I do not wish to prejudge the answer to those questions, but it does strike me that in particular where the latter case is concerned that in this instance the burden of proof is on the industry to show that the special tax breaks, which were applied for, which were granted on the understanding that the industry needed them to go out and look for oil, that those breaks have somehow not boomeranged, come around in full circle, and boomeranged upon Congress that granted them by helping the industry to finance a merger wage.

And that seems to me is an area where the industry must convince us. I thank you, Mr. Chairman, for this opportunity.

Senator **Warner**. Senator Melcher.

STATEMENT OF HON. JOHN MELCHER, A U.S. SENATOR FROM THE STATE OF MONTANA

Senator **Melcher**. I am delighted we are having this hearing. I think it was scheduled long before the issue came up about the mergers. I suspect that that is going to dominate through the subject matter of the hearing and the testimony and the questioning of this hearing. It is going to be dominated by the mandate from the Senate resolution to have a study of the oil company merger situation.

This committee has certain responsibilities that are connected with that resolution. However, I am going to be also concerned about the nuts and bolts of the leasing program on Federal lands and particularly as to what is happening to the lottery system or what is going to replace it and why the Department of the Interior is having difficulty figuring out what a known geological structure is and, therefore, having competitive bidding on leases, whether that knowledge is available.

It seems to me that it is rather ironic that we have to be looking over the shoulders of the Department of the Interior after all of these years to ascertain what is a known geological structure and find out whether we are going to use competitive bidding or not. I would be very interested in those kinds of nuts and bolts. I am not sure if we will get to that stage or if this committee will be dominated by oil company mergers.

Before we are all done, I hope the Department can supply us with information on these very basic questions.

Thank you, Mr. Chairman.

Senator **Warner**. Thank you. The chairman carefully talked to a number of Senators with respect to their interest in possibly introducing future legislation along the lines of that which prompted this hearing. The Chair received no indication of members that the legislation will likely surface again in the immediate future, nevertheless we will go ahead with this hearing and contribute to the record what will be compiled pursuant to the Senate resolution.

Now, on the procedural aspect of this hearing, as you are well aware the Senate today is in recess at the loss of one of our most distinguished colleagues. The Chair, in deciding whether to postpone this hearing out of respect for Senator Jackson, carefully assessed the fact that this hearing had been scheduled since March 7 and many have traveled from afar to be here. The time of the hearing was set for 9:30 so the Senators could be present prior to services, and we will continue this hearing following the services so that all Senators can be accommodated.

We will, however, in deference to our colleague and with respect to the services being adjourn the hearing from 11 to 11:10.

Further, there are a substantial number of witnesses, ladies and gentlemen, that desire to be heard today. It is the chair's desire that questioning by individual Senators be limited to 5 minutes of each panel; secondly, that the witnessess address in their testimony those issues which are germane to the jurisdiction of this committee.

There is no desire on the part of the Chair to compile a record which is duplicative of that previously compiled by the Finance and Judiciary Committees. Consequently, it is the Chair's hope that the witnesses can in a very brief period of time address those aspects of their testimony which are germane to the jurisdiction of this committee.

If there are no further questions or statements, we will now hear from our first panel and the very distinguished Deputy Secretary of the Department of Energy, Mr. Boggs.

STATEMENT OF HON. DANNY J. BOGGS, DEPUTY SECRETARY, DEPARTMENT OF ENERGY

Mr. Boggs. Thank you, Mr. Chairman, and members of the committee. I am pleased to be here today to present the Department of Energy's position on S. 2362 in particular, and bills to discourage financial transactions in the oil and gas industry in general. As requested our written testimony submitted for the record will address the effect of mergers and financial dealings in the oil industry on such topics as energy supply, capital availability, energy security and competitiveness in the oil and gas industry.

It is our conclusion that there is no good evidence that permitting such dealings would be harmful to the American energy position. Instead, we believe that interference with financial transactions could harm the optimum development of our energy resources, both directly and indirectly. Directly, by reducing the possible rewards of exploration and indirectly, by demonstrating that the Government is returning to a position of hasty intrusion in energy markets, thus rendering the return on energy activities more uncertain and the activity itself more costly.

I will give a brief summary of several of the specific points that are covered in the testimony. With regard to capital availability, the simple point is that the money which is used in these transactions does not disappear. It is a financial transaction, not an investment in physical assets. No more than the buying and selling of existing houses discourages people from the building of new houses.

With regard to competitiveness, although this is primarily within the purview of the antitrust division of the Justice Department and the Federal Trade Commission, we see no evidence that the concentration ratios, on a national basis, of any of the aspects of the oil and gas industry are getting out of line with what they have historically been. We certainly do not see that legislation which in effect provides existing management with a golden hammerlock on their jobs promotes competitive vigor within the oil and gas industry.

With regard to energy supply, we clearly believe that drilling and exploration and production of hydrocarbons is determined by the price that is available and by the cost that must be incurred. Certainly for the industry as a whole, this is not affected on an overall basis, and we do not believe it is affected for individual companies, but certainly not for the industry.

Many people, many independents, and small companies in fact drill for the purpose of selling reserves. Legislation such as S. 2362 would mean that exploration for that purpose would be restricted because one could no longer sell those reserves to any of the top *x* number of companies, depending on the legislation, but certainly a very significant number of companies and by making that unattractive or impossible there would be less incentive for others to drill.

Similarly, it is riskier to be in the oil business if one cannot undertake normal purchase and sale transactions of assets.

Thus, with no effect on energy supply, we see no significant adverse effect on national security either.

Finally, I would note that S. 2362, the particular legislation in its attempt to discourage financial transactions, would have the effect of potentially damaging key parts of the energy program, the OCS leasing program and transportation of energy. Should a company decide that a particular financial transaction were sufficiently attractive to go ahead and do it despite the discouragement, we would then be weakening the OCS program.

Finally, Mr. Chairman, for the record, I would like to submit, because I am not a tax expert, and I see that none of our witnesses are, the testimony that was given by the Department of Treasury before the Finance Committee so that might be made a part of the record, if you would.

The CHAIRMAN. It will be made a part of the record.

[The prepared statements of Mr. Boggs and Mr. Pearlman follow:]

STATEMENT

OF

DANNY J. BOGGS
DEPUTY SECRETARY
U.S. DEPARTMENT OF ENERGY

BEFORE THE
COMMITTEE ON ENERGY AND NATURAL RESOURCES
SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
U.S. SENATE

APRIL 10, 1984

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to appear before you today to address the issue of oil company mergers. Specifically, you requested that the Department address the effects of anti-merger and merger moratorium legislation on America's mineral leasing programs, energy supply, capital availability, national security, competitiveness of oil and gas industry and America's position in the international energy arena.

In October 1983, the Administration transmitted to the Congress the National Energy Policy Plan IV (NEPP) which sets forth a clear statement of energy policy for the Nation. The goal is to provide an adequate supply of energy at reasonable costs. Our strategies for achieving our energy policy goal are two-fold: (1) to minimize Federal control and involvement in energy markets while maintaining public health and safety and environmental quality, and (2) to promote a balanced and mixed energy resource system.

Ensuring that the U.S. has a competitive, dynamic, and efficient domestic oil and gas industry is an essential component of our goal of adequate energy supply at reasonable costs. From an energy standpoint, we do not see any need for an anti-merger bill or a merger moratorium bill. In fact, we believe that such legislation could seriously reduce the effectiveness of the domestic oil and gas industry by increasing Federal control and involvement in the energy market.

One of the great obstacles to sound energy policy and sound energy investments is the well-justified fear that Congress will step in and overturn or thwart any private energy strategy. Proposed legislation that prevents financial transactions in energy assets is just another step making Americans leery of investing in energy. As I explain more fully below, these mergers would have no adverse effect on exploration and development of energy resources. The Administration is completely opposed to restrictive oil merger legislation in any form, be it "temporary" or permanent, prospective or retroactive.

MINERAL LEASING PROGRAMS

The Federal mineral leasing programs are primarily the responsibility of the Department of the Interior. The effects of anti-merger legislation on these programs are best addressed by that Department. Because the Outer Continental Shelf (OCS) leasing program contributes significantly to the Nation's oil and gas supply, however, the Department of Energy is concerned about any proposed legislation that might discourage participation in the program. We believe that anti-merger legislation, and particularly a moratorium on offshore leasing for specified companies, would reduce the bidding for leases and hence the development of potentially rich tracts.

Effect on OCS Leasing Program

OCS bidding is very competitive. Many firms participate, and participation by major oil companies is especially high. In August and May 1983, there were approximately 78 companies, both majors and independents, which offered joint and solo bids on over 650 Gulf Coast offshore tracts. Many firms have found that bidding in concert with other firms offers spreading of risks and economies of scale in terms of pooling their capital and technological expertise in high-risk and high-cost tract development. The joint bidding also broadens the range of U.S. firms participating in OCS development.

S.2362 would directly affect about 150 domestic oil companies and would discourage them from participating in an OCS lease sale if they are contemplating a merger. S.2362 has the potential to dramatically reduce bidding on and development of our OCS resources.

EFFECTS OF MERGERS ON U.S. ENERGY SUPPLY

Oil company mergers will not reduce and could possibly increase domestic exploration activity. In contrast, anti-merger legislation could discourage domestic exploration, and thereby adversely affect our Nation's energy supply.

Historical Review of Domestic Exploration Activity

Domestic exploration activity can be usefully separated into three distinct periods:

- pre-Arab Oil Embargo (1960-1973)
- post-Arab Oil Embargo (1974-1979)
- post-domestic oil price decontrol (1980-present)

Between 1960 and 1970, domestic wellhead oil price fell in real terms from $3.13 to $2.88 per barrel (1967 dollars). Domestic oil exploration activity also gradually declined during that period. Seismic crews declined from 385 in 1960 to 195 in 1970. The total annual footage drilled declined from 192 million feet in 1960 to 139 million feet in 1970.

The oil price increases in 1973/74 reversed the decline in domestic exploration. Within six months of the Arab Oil Embargo, world oil prices increased more than 285 percent.

Federal price controls on domestic oil production held exploration activity below free market levels, but the domestic wellhead price of new oil was allowed to rise from $3.89 in 1973 current dollars to $12.15 in 1978. In response, the average number of seismic crews working increased from 305 in 1974 to 530 in 1980. Annual drilling expenditures doubled in real terms over the same period. Wellhead prices for intrastate natural gas also rose steadily during this period. Gas drilling activity also increased, especially after FPC Opinion 770 in 1976, which allowed greater incentives for new discoveries.

Domestic oil price decontrol in 1981 and the gas price increases permitted by the NGPA caused U.S. exploration activity to reach unprecedented levels by 1982. In 1983, total wells drilled declined 11 percent from the peak in 1982. But despite the recent decline, total wells drilled for each year since 1981 numbered over 75,000, an increase of more than 25 percent over any previous year.

The February 27, 1984 Oil and Gas Journal projects that total U.S. industry expenditures for drilling and exploration for 1984 will be 2.2 percent lower than in 1983. This anticipated decline in expenditures stems from both the 1982-83 drop in official and spot prices for crude oil and the lower costs of drilling. Total expenditures are still likely to be very high compared with historical spending for exploration. In fact, the reduced drilling costs, the recent stabilizing of crude oil prices, and our economic recovery have all caused a slight upturn in oil and gas drilling activity. In the first 8 weeks of this year 7% more oil wells were completed and 2% more gas wells were completed than in the same period last year.

In summary, the level of domestic exploration activity has changed quickly and dramatically in response to changing conditions over the last 25 years. As one might expect, the level of exploration activity appears to be highly correlated with current wellhead prices and drilling costs. Thus to reiterate, the level of domestic exploration activity will not be adversely affected by oil company mergers.

With respect to the effect of oil company mergers on exploration activity, we have a limited amount of relevant data. We have looked at domestic exploration and development expenditures for five recent mergers. These are: Shell/Belridge, Sun Oil/Texas Pacific, Dupont/Conoco, U.S. Steel/Marathon Oil, and Occidental/Citgo. The data do not support the contention that mergers reduce exploration activities; in fact, several cases resulted in increased exploration. The annual growth in expenditures over the 1978-82 period for four specific mergers was about 20-26 percent, compared with about 17 percent for the industry as a whole.

Economic Determinants of Exploration Activity

For an individual firm, the factors that affect that company's level of exploration activity include:

- expected oil and gas wellhead prices
- the geological attractiveness of undrilled prospects
- lease, seismic, and drilling costs
- the firm's cost of funds
- the expected profitability of exploration relative to other company investment opportunities
- the firm's capacity to absorb risk
- taxes

I believe the primary determinants of U.S. drilling activity are expected future oil and gas prices and the geological attractiveness and development costs of undrilled domestic prospects. Since oil company mergers will not affect these factors, a merger should not significantly affect exploration activities of the combined companies. Even less should it affect the combined willingness of the thousands of companies in the industry to drill attractive prospects.

A merger can significantly affect several of the other factors that determine exploration activity. The merged firms may have a different tax status or a different cost of funds. The merged firm may have a higher capacity to absorb risk or may have more technical expertise in the exploration process. But regardless of the effect of the merger on the individual company's exploration activity, the overall level of exploration activity in the U.S. will not be affected by oil company mergers.

The argument that mergers among major oil firms will somehow divert funds that would otherwise have gone into developing new reserves is contrary to observed investment behavior in free markets. It implies that the use of capital is primarily determined by corporate structure, rather than the prospect of profit. This is untrue. The level of investment in oil and gas exploration and production depends on the projected rate of return on such investments, not the ownership structure of the companies engaging in the oil business. This is clearly demonstrated by the history of the 1970's, when rapid increases in price attracted huge new inflows of capital to the industry.

We are concerned that S. 2362 would discourage domestic exploration, and thereby adversely affect our Nation's energy supply. More than 150 companies currently hold hydrocarbon reserves in excess of 10 million barrels. S. 2362 would attempt to prevent mergers, not by banning them outright, but by discouraging exploration by those companies contemplating mergers. S. 2362 would have the direct effect of discouraging these companies from bidding in Federal lease sales. In addition, it would have the indirect effect of discouraging smaller firms from exploring, because they will be unable to sell the reserves they discover to one of the larger companies. The indirect effect of making exploration less attractive to the smaller companies could have a substantial adverse effect on domestic exploration activity.

For these reasons, I see no need for anti-merger or merger moratorium legislation on the basis of energy supply considerations. To the extent that such legislation inhibits the efficient adjustment of the industry to changing supply and demand conditions, such legislation would have an adverse effect on America's energy supply.

CAPITAL AVAILABILITY

The issue of capital availability is more properly addressed by the Treasury Department but we are concerned that the proposed anti-merger legislation has the potential to restrict the capital that investors make available to domestic exploration companies. I would like, however, to make two brief observations on the capital availability issue as it relates to domestic energy supply.

The $30 billion transfer of funds that will occur if the three proposed mergers are concluded, must be put in the proper context. It is a financial transaction, not an investment or disinvestment in physical assets. Every hour of every day there are vast numbers of similar transactions in oil and gas assets, through farmouts, reserve sales, working interest purchases and the like. The aggregate sum of these transactions, as companies rearrange their reserve and exploration positions, dwarf the mergers being discussed.

The $30 billion will be easily accommodated by the Nation's financial markets. This sum represents less than one percent of the U.S. bank lendings for investment. The corporate assets acquired are likely to generate enough revenues to offset any interest payments on loans taken to finance the merger.

The second point I would like to make is that the capital expended by the acquirer for these mergers is capital provided for investment by the stockholders of the acquired company. As

Federal Reserve Board Vice Chairman Preston Martin has said, "These oil takeovers do not harm U.S. credit markets despite the large funds involved ... such takeover activity can result in a great shift of funds for around 7 to 10 days but the money involved does not go into a black hole".[1]

The merged corporation is often in a better financial position with respect to oil and gas supplies. For example, a merged corporation might pool technological expertise with capital assets in order to invest in high-risk and high-cost tracts of land. Economies of scale resulting from mergers can yield a more efficient operation, with a greater capability of adding to and developing our Nation's energy reserves. Therefore, mergers will not reduce the capital availabile for domestic exploration and other investments in the domestic economy. In contrast, anti-merger legislation has the potential to restrict the capital that investors make available to domestic exploration companies.

1/ Source: Preston Martin, Federal Reserve Board Vice Chairman, Speaking before the National Advisory Council of the Senate Committee on Small Business, March 15, 1984.

NATIONAL SECURITY

As I have stated previously, I do not believe that oil company mergers in any way diminish our ability to meet our energy needs, therefore, it is my conviction that such mergers pose no threat to the security of our Nation. On the other hand, legislation that would restrict merger activity could have an adverse effect.

I would like to briefly comment on three issues which have been raised in connection with mergers and our national security interests: (a) the potential threats posed by mergers to the economic competitiveness of our society, (b) the threat of an increased level of oil imports, and (c) the threat of increased foreign investments in our economy.

The U.S. has long been concerned about preserving competition in the marketplace. The threat that a large corporation, which holds a large share of the total supply of goods or services, can control prices by deliberately restricting output has been adequately addressed both by law and by administrative institutions. Indeed, one reason for the cry for special legislation to punish these mergers is that they are so clearly legitimate by most measures of concentration, and because the FTC has moved strongly in those other instances that might jeopardize the competitiveness of specific markets.

As to the second issue, there is no evidence to believe that mergers will cause a reduction in domestic exploration or otherwise reduce supply. Therefore, we see no factors that would cause mergers to lead to an increase in our import levels. On the contrary, to the degree that such mergers increase the efficiency of our domestic oil and gas industry, they will improve our domestic energy supply, and therefore contribute to our Nation's energy security.

Finally, with respect to the argument that the divestiture of assets (such as refineries and gasoline stations) in such mergers might precipitate a potential for increased foreign investment opportunities, we believe the anti-trust laws are adequate to govern such situations while preserving an open market place. I would note that many refineries and gasoline stations have been available for purchase over the past few years with no such effect observable. Consequently, I believe it unlikely that the mergers would in fact cause a substantial increase in foreign ownership. In summary, the proposed oil company mergers will neither jeopardize the competitiveness of our economy, diminish our energy supply, nor pose a threat to our energy security.

COMPETITION IN THE DOMESTIC OIL INDUSTRY

The FTC and the Department of Justice share enforcement authority over the anti-trust provisions of the Clayton Act, and have ample authority to prevent mergers that would reduce competition in the domestic oil industry. The FTC will review the three recent merger proposals for compliance with U.S. law. A conditional consent order has been made available for public comment on the Texaco/Getty merger.

The domestic petroleum industry is extremely competitive and dynamic. I reached this conclusion by comparing the petroleum industry with other industries in terms of the percent of specific market shares held by the top 4 and top 8 companies. When compared with other major U.S. industries, such as steel or automobiles, major petroleum corporations have a much lower measure of concentration in market share.

The data also shows that petroleum production, has become even more competitive since the early 1970's. Between 1970 and 1982, the four firm market share for crude oil production declined from 26.4% to 25.2% and the eight firm market share declined from 41.79% to 39.2%. These concentration ratios are far below the level at which the FTC and Department of Justice would define a market as being concentrated or uncompetitive.

Additionally, there is strong competition even among the top ranked major oil companies, as evidenced by the shifting in rank for those commanding the largest market shares. This turnover demonstrates the ability of and the incentives for even large corporations to adapt to a changing energy market. Mergers which have occurred within the last several years (since the 1970's and since 1981) have not reduced competition in the petroleum industry. I do not anticipate that merging of a major and an independent firm or even of two major firms will change these firms' incentives to compete and enhance the efficiency of their operations.

U.S. POSITION IN INTERNATIONAL OIL AND GAS MARKET

U.S. oil and gas companies are among the world's leading industrial firms in terms of sales, assets, and income. These corporations contribute significantly to many countries' national incomes both in terms of revenue generated and in terms of their vital role in supplying the intermediate products used by major industries. These petroleum corporations compete vigorously in the world oil market. Of the world's 40 leading oil and gas corporations, excluding OPEC, 18 are U.S. firms.

To the extent that the recent domestic oil companies' mergers have financially strengthened the companies involved, increased their technical expertise, and increased their ability to bear large risks, the mergers have enhanced the ability of domestic oil companies to compete in the world oil market.

CONCLUSION

Oil company mergers, such as those which have occurred recently, are a clear example of the market place at work. They demonstrate the ability of the domestic oil and gas industry to adjust quickly and efficiently to changing circumstances. Such mergers will not have any adverse affect on America's mineral leasing programs, energy supply, capital availability, national security, or our position in the international energy arena. In fact, there is a strong possibility that the newly combined firms would be more effective in the exploration for and development of our oil and gas resources. Conversely, restricting the ability of companies to operate freely in the marketplace could adversely affect us in these areas.

With respect to competition in the oil and gas industry, existing anti-trust laws provide both the Department of Justice and the Federal Trade Commission with ample authority to review and analyze the effect on competition of mergers among major oil companies. Both the Department of Justice and the FTC have statutory authority to sue to enjoin any mergers that would substantially lessen competition and to seek other appropriate relief against any existing oil company that is restraining competition. Justice also has authority to sue for recovery of any damages the Federal government itself may have suffered as a result of violations of the anti-trust laws.

For these reasons, we oppose any anti-merger legislation, including a moratorium, that could arbitrarily interfere with the operation of the capital markets and create unnecessary confusion and disruption, while adding nothing to the Federal government's ability to prevent and remedy any anti-competitive actions which may occur in this industry. As a matter of energy policy, we presently see no reason why energy company mergers should be treated differently from other types of mergers, which frequently can result in consolidating and strengthening firms in all sectors of our economy. We are concerned that interference with such energy investments would only drive available resources away from the energy sector, and in turn, impact the primary goal of the President's National Energy Policy Plan which is to ensure that "Americans have an adequate supply of energy at a reasonable cost". The Department of Energy therefore opposes oil merger legislation like S. 2362. Such legislation is both unnecessary and counterproductive.

For Release Upon Delivery
Expected at 9:30 A.M., E.S.T.
April 5, 1984

STATEMENT OF
RONALD A. PEARLMAN
DEPUTY ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON ENERGY AND
AGRICULTURAL TAXATION
OF THE
SENATE FINANCE COMMITTEE

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before you today to discuss some of the more significant Federal income tax consequences affecting acquisitions of oil and gas corporations. The number of highly publicized acquisitions (and proposed acquisitions) of large, publicly held corporations primarily engaged in the oil and gas business has renewed concern that our tax laws may encourage these transactions. Although we do not know the motivations for the recent flurry of merger activity, we doubt that it is primarily tax motivated. Rather, these acquisitions may be motivated by such other factors as a decrease in demand for oil, an increase in costs of exploration for new oil and the shrinking of reserves, the undervaluation of such reserves in the stock market, or any number of other factors. The determination of the anticompetitive aspects of these acquisitions is a matter for the Justice Department and the Federal Trade Commission, and we defer to their expertise in that area.

The first part of my testimony summarizes the alternative structures that are most frequently employed to effectuate these acquisitions and the associated tax consequences of those structures to the acquiring corporation, the target corporation and the shareholders of the target corporation. The second part of my testimony describes those provisions of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") that were directed at unwarranted tax benefits attainable under prior law in corporate mergers and acquisitions, and describes the effect of those provisions on oil and gas corporation acquisitions. Finally, the third part of my testimony describes other provisions of the Internal Revenue Code that have a direct bearing on acquisition transactions.

I. Tax Treatment of Corporate Acquisitions

The acquisition by one corporation of the business of another corporation can be accomplished in a variety of ways, and the tax consequences of each alternative acquisitive structure may differ significantly. Most acquistions, however, involve the direct acquisition of the target corporation's assets or its stock. In either case, the acquisition can be structured either as a tax-free "reorganization" or as a taxable transaction.

A. Tax-Free Reorganizations

If a transaction qualifies as a statutorily defined "reorganization," it generally will be tax-free to the target corporation, even if that corporation has appreciated assets. Depending on the application of sections 381, 382, and 383, the tax attributes of the target corporation generally will survive the reorganization and carryover to the acquiring corporation. Most significantly, the target corporation's tax bases for its assets "carryover" to the acquiring corporation and are not "stepped-up" (or down) to fair market value. Furthermore, no gain or loss will be recognized by the selling shareholders to the extent of qualifying consideration received (generally stock of the acquiring corporation). Receipt of qualifying consideration permits these shareholders to defer recognition of the gain or loss that was built into their stock.

B. Taxable Asset Acquisitions

If a transaction is a taxable acquisition of assets from a non-liquidating corporation, gain or loss will be recognized by the selling corporation. If, however, the sale is an installment sale, gain is deferred and reported as the installment payments are made. In either case, the tax bases of the assets acquired are adjusted to reflect the purchase price paid for those assets. The acquiring corporation does not succeed to any of the target corporation's tax attributes. The shareholder of the selling corporation generally does not recognize gain or loss, unless the proceeds of the sale are distributed.

If a transaction is a taxable acquisition of assets from a corporation that has adopted a plan for complete liquidation within a 12-month period, generally no gain or loss is recognized by the selling corporation (except to the extent of recapture income and other tax benefit items). Gain or loss is recognized, however, by the shareholders of the liquidating corporation based upon the difference between the amount of the liquidation proceeds received and their stock basis. If the corporation sells its assets for installment notes and distributes the notes in liquidation, the shareholders of the liquidating corporation can report the gain on the installment basis to the extent they receive installment notes. The tax consequences to the acquiring corporation are the same as in the case of an acquisition of assets from a non-liquidating corporation.

C. Taxable Stock Acquisitions

If a transaction is a taxable acquisition of stock of the target corporation, gain or loss generally will be recognized by the selling shareholders. In addition, recapture income and other tax benefit items may be taxed to the target corporation, depending on whether the purchasing corporation makes an election to adjust the bases of the target corporation's assets. If no election is made (or deemed made), the target corporation, which becomes a subsidiary of the purchasing corporation, continues its historic asset bases, along with its other tax attributes. An election gives the purchasing corporation cost bases for the acquired assets and generally extinguishes the other tax attributes of the target corporation.

II. TEFRA

A. Corporate Partial Liquidations

TEFRA altered the tax rules for corporate acquisitions to eliminate some unwarranted tax benefits obtained in corporate acquisitions and to align more closely the tax consequences of taxable asset and taxable stock acquisitions. For example, prior to TEFRA, a common scheme involved the acquisition of the stock of a target corporation in a taxable transaction followed by a distribution by the target corporation of a portion of its assets in a partial liquidation. If the plan were structured properly, the distribution to the acquiring corporation might be treated as a payment in exchange for stock rather than as a dividend distribution, with the result that (i) the bases of the distributed assets in the hands of the acquiring corporation would be stepped-up to their fair market values, (ii) neither the target nor the acquiring corporation would currently recognize any recapture or other gain on the transaction (the recapture income generally would be deferred and recognized only in future periods pursuant to the consolidated return regulations), and (iii) the tax attributes of the target corporation would continue to be available. In TEFRA, the tax treatment of these corporate partial liquidations was changed to ensure that the acquiring corporation generally would not obtain a step-up in the bases of assets distributed unless recapture income were recognized.

B. Section 338

TEFRA also contained measures to simplify and improve the tax treatment of taxable stock acquisitions. These improvements, found in section 338, provide that where a corporation purchases at least 80 percent of the stock of a target corporation over a 12-month period, the purchasing corporation may elect to adjust the bases of the assets of the target corporation as though the target corporation sold all of its assets to a new corporation in connection with a plan for complete liquidation within a 12 month period. The price at which the assets are deemed sold is generally the purchasing corporation's basis in the target's stock at the acquisition date. The target generally will recognize the recapture income and other tax benefit items corporations usually recognize when they sell their assets pursuant to a plan of liquidation.

Section 338 also contains a number of consistency rules designed to prevent a purchasing corporation that acquires the stock of a target corporation from obtaining a step-up in bases for some of the target's assets, while preserving target's tax attributes and historic bases for other assets. The typical case addressed by these rules is one where target has one group of high value, low basis assets which are more valuable to a purchaser than to target by reason of the purchaser's ability to take cost recovery and depletion allowances on a stepped-up basis, another group of assets which may carry a significant recapture or other tax cost upon disposition, and valuable tax attributes (such as net operating loss or credit carryovers). If the purchasing corporation were to acquire all of target's assets, all assets would receive stepped-up bases, target (assuming target liquidated within a 12-month period) would be taxed only on the recapture and tax benefit items on all assets, and the tax attributes of target would be extinguished. From a tax planning perspective, the purchasing corporation would like to step-up the bases of the first group of assets (for instance, by a direct asset purchase), yet avoid the recapture tax and maintain a carryover of bases for the second group of assets and the valuable tax attributes of target (by acquiring all of the target stock and not making a section 338 election).

To prevent tax motivated manipulation in cases of this type, the consistency rules require that with respect to all of target's assets acquired, the purchasing corporation must elect either to step-up the bases of all acquired assets (with the associated recapture and loss of tax attributes) or to carryover the bases of all acquired assets (generally with the continuation of tax attributes). Section 338 generally provides that a step-up in bases (and attendant recapture and other tax consequences) will be triggered automatically if, within the period ("consistency period") beginning one year before the beginning of the acquisition and ending one year after 80 percent control is acquired, any member of the purchasing group acquires the stock of any corporation affiliated with the target corporation (target group) or an asset from any member of the target group, other than in certain defined transactions. The excepted transactions included transactions in the ordinary course of business, carryover basis transactions, pre-effective date transactions, and other transactions to the extent provided in regulations. */

C. Application of Section 338 to Oil Corporation Acquisitions

If the acquisition by one oil corporation of another is structured as a taxable stock acquisition, section 338 would be applicable to the transaction if at least 80 percent of the target corporation's stock is purchased within a 12-month period. Accordingly, the acquiring corporation will have to decide whether it wishes to obtain carryover bases in all of the target's assets acquired or obtain step-up in bases in such assets and pay tax on the recapture and other tax benefit items that would be triggered by the acquisition. We understand that in one or more of the recently announced oil corporation

---

*/ In some cases, the consistency rules can operate to require taxpayers to take a step-up in basis and pay recapture taxes or suffer other tax detriments where no manipulative scheme exists. Treasury is considering allowing taxpayers to elect carryover bases (or cost basis when less than carryover basis in a particular asset) in all assets that a corporation acquires during the consistency period. We do not believe that the providing of this "carryover basis election" would create any significant new tax incentives for corporate acquisitions. Although Treasury may have the authority to provide such an exception to the consistency rules in regulations under current law, this would create the possibility of a whipsaw against the Treasury. If such an election were provided in regulations, a taxpayer may be able to elect a carryover basis for purposes of section 338 to avoid a deemed election under the consistency rules, and yet later claim the higher cost basis under the general rules governing the determination of asset basis. We believe that an appropriate statutory carryover basis election would eliminate this whipsaw potential.

acquisitions, the acquiring corporations may not make section 338 elections to step-up the bases of all of the assets of the target corporations because the amount of the recapture tax liability is disproportionate to the benefit of the step-up in bases. In these transactions, it appears that the consistency rules added by TEFRA are achieving their purpose.

D. General Utilities Doctrine

Some have argued that the section 338 rules and the liquidation rules conflict with the general scheme for taxing a corporation and its shareholders. Generally, a corporation is subject to tax on the profits derived from its operations and its shareholders are subject to a second level of tax on the distributions of those profits as dividends. In a liquidating sale of assets or sale of stock with a section 338 election, there is a step-up in bases of assets with only a partial corporate level tax; recapture income and tax benefit items are taxed, but other potential gains are not. This result stems from the rule attributed to General Utilities & Operating Co. v. Helvering, 296 U.S. 200 (1935), that is now codified in sections 311(a), 336, and 337. Under those provisions, a corporation recognizes no gain (other than recapture and tax benefit items) on distributions, including liquidating distributions, made to its shareholders. These rules may give an additional incentive to a corporation to sell assets in some cases because it increases the likelihood that some assets may be more valuable to a buyer than to a corporation that owns the assets. This could occur whenever the present value of the tax benefits that go along with property ownership (e.g., depreciation and depletion deductions) exceed the seller's tax detriment incurred on the sale.

Congress has reduced this incentive to sell corporate properties by limiting the scope of the General Utilities rule. For example, TEFRA made distributions of appreciated property in a partial liquidation taxable to the distributing corporation. In addition, H.R. 4170 and the Finance Committee's Deficit Reduction Act of 1984 will impose the same treatment on dividend distributions of appreciated property. One major aspect of the General Utilities doctrine remains, however. Nonrecognition of gain by the selling corporation continues to be the general rule in connection with a complete liquidation and a deemed asset sale in connection with a section 338 election (although recapture and tax benefit items are taxed). While repeal of this last major exception would simplify the tax laws, we do not believe that the failure of the corporate tax regime to impose two levels of tax on liquidation transactions should be viewed as motivating oil corporation acquisitions. Further, as we have indicated in prior testimony before the Finance Committee, we believe that in considering the repeal of General Utilities in liquidation transactions, relief from double taxation of liquidation proceeds must also be considered.

III. Other Tax Aspects of Oil Corporation Acquisitions

A. Corporate Level Tax on Distributions of Royalty Trust Interests.

As noted above, under current law the General Utilities doctrine applies when a corporation distributes appreciated property to its shareholders as a dividend. The failure of current law to tax dividend distributions of appreciated property to the distributing corporation causes a reduction in the corporate income tax base and is inconsistent with the treatment accorded nonliquidating sales of appreciated property, since, in effect, the amount of the appreciation occurring while the asset is in corporate solution is never subject to corporate income tax. Thus, when a corporation distributes property with a basis to it of $100 and a value of $300, the resulting $200 of appreciation is removed from the corporate income tax base. Further, that appreciation may be removed entirely from the income tax base, since a recipient individual shareholder takes a fair market value basis for the asset received. Finally, all of the future income to be derived from the assets distributed are removed from the corporate tax base.

To deal with this problem, both H.R. 4170 and the Finance Committee's Deficit Reduction Act of 1984 contain an Administration proposal, which was greatly influenced by the preliminary report prepared by the Staff of the Finance Committee on The Reform and Simplification of the Income Taxation of Corporations, to subject dividend distributions (other than to an 80 percent controlling corporation and certain other cases) of appreciated property to corporate level taxation. This proposal would subject the distribution of an appreciated mineral property interest held in a royalty trust to corporate level taxation. If this provision is enacted, there will be little remaining tax incentive for the distribution of such interests.

B. Corporate Level Recapture Tax on Mineral Property

Under current law, gain on the disposition of mineral property is taxable as ordinary income under section 1254 to the extent of intangible drilling costs that were deducted after December 31, 1975. However, no such recapture exists with respect to mineral property for which intangible drilling costs were deducted prior to that date. Consequently, on the sale or exchange of mineral properties, gain attributable to expenses deductible against ordinary income as intangible drilling costs prior to 1976 is taxable at capital gain rates even though the drilling expenses were deducted against ordinary income.

Prior to 1975 integrated oil companies were able to deduct percentage depletion at a rate of 22 percent with respect to mineral property. Percentage depletion deductions were not limited to the taxpayer's basis in the mineral property. Since 1975 integrated oil companies have been required to use cost depletion. Upon the disposition of mineral property, however, current law does not require the recapture of either cost or percentage depletion allowances; this rule applies equally to that portion of percentage depletion allowances taken in excess of the taxpayer's basis.

Some have suggested that recapture rules should be applied to intangible drilling costs deducted in respect of mineral properties regardless of when the deductions were taken. We cannot support such a change. The recapture of intangible drilling costs was considered extensively by Congress in connection with legislation in 1976. Congress enacted a recapture provision at that time and settled upon what it considered to be a fair transition rule. We do not believe that it is appropriate to change that transition rule retroactively.

Suggestions also have been put forth to apply recapture rules to percentage and cost depletion allowances. The cost depletion allowance is unlike other recapturable deductions such as depreciation or cost recovery allowances in that it more closely approximates economic depletion. Any gain realized upon a sale or other disposition of mineral property with respect to which cost depletion was allowed relates mainly to an increase in value of the undepleted remaining minerals and not to excess tax benefits claimed with respect to the depleted minerals. Finally, with respect to percentage depletion, Congress dealt with the policy considerations involving the availability of this special tax incentive to integrated oil companies by limiting such taxpayers to cost depletion for taxable years ending after December 31, 1974. We would not support a retroactive limitation on these taxpayers' pre-1975 percentage depletion benefits.

C. Tax Aspects of Acquisition Indebtedness

Some have suggested that the income tax law encourages highly leveraged buy-outs of oil corporations by permitting the acquiring corporation to deduct interest paid or accrued on debt incurred in connection with the acquisition and to deduct cost recovery and depletion allowances even though gain is deferred by the seller through the use of the installment sale rules.

Section 279 disallows an interest deduction, under very limited circumstances, where debt is used to acquire stock or assets of another corporation. Outside of this limitation, there are no unusual tax consequences to using debt for acquisitions. The corporation is entitled to an interest deduction on the acquisition indebtedness, and such interest is paid to a bank or other person who generally is subject to tax on such amounts. Because the use of debt for acquistions is not significantly different from debt used for other corporate purposes, there should be no unusual tax consequences to using debt for acquisitions.

However, the use of installment debt may lead to a mismatching of the gain that is deferred by the seller and the allowance to the purchaser of cost recovery or depletion deductions. This mismatching of income and deductions may create a tax bias for installment debt-financed acquisitions. In a taxable corporate acquistion (an asset acquisition or a stock acquisition with a section 338 election), this mismatching is reduced to some extent if the target corporation's assets are subject to recapture tax since the recapture income generally is recognized immediately.

The mismatching problem with respect to installment debt is present throughout our current tax system and is not unique to oil corporation acquisitions. It should be noted that the Finance Committee's Deficit Reduction Act of 1984 contains a provision which precludes recapture income with respect to real property from being reported on the installment method.

D. Dividends Received Deduction

In general, the Internal Revenue Code allows corporations (other than an S corporation) a deduction equal to 85 percent of dividends received. A 100 percent dividends received deduction is allowed for dividends paid by affiliated corporations (where the recipient corporation has an ownership interest of 80 percent or more), and in the case of dividends paid by certain small business investment companies. In addition, where such corporations file a consolidated return, intercompany dividends are eliminated.

The purpose of the intercorporate dividends received deduction is to prevent multiple taxation of income as it flows from the corporation that earns the income to the ultimate noncorporate recipient of the income. If a corporation borrows funds for the purpose of making a portfolio investment in stock of another corporation, interest on the borrowing generally is deductible by the corporation making the investment. The opportunity to create double deductions for the receipt of dividends and the payment of interest in these transactions is inconsistent with the purpose for the intercorporate dividends received deduction. However, this is not an inconsistency with respect to stock investments in controlled corporations, both where a consolidated return is filed and where separate returns are filed.

To deal with this problem, both H.R. 4170 and the Finance Committee's Deficit Reduction Act of 1984 contain an Administration proposal to disallow interest on debt that is directly attributable to a portfolio investment in stock (which does not include 80 percent or greater interest in the stock of another corporation). This matter also was discussed in the preliminary report prepared by the Staff of the Finance Committee on The Reform and Simplification of the Income Taxation of Corporations. This proposal generally would not impact oil corporation mergers, although it could discourage leveraged acquisitions of minority stock investments that are made with a view to an eventual takeover or merger.

E. Windfall Profit Tax

There has been a suggestion that in the acquisition of an oil corporation, there is an advantage to be gained under the windfall profit tax through a transfer of oil producing properties. This is not the case.

The amount of windfall profit subject to tax is the difference between the base price of the oil and the price for which the oil is sold, reduced by a severance tax adjustment. The lowest base price and the highest rate of tax is applied to tier 1 oil, which generally is oil produced from a property that was in production before 1979. For integrated oil companies the highest base price and the lowest tax rate applies to newly discovered oil in tier 3, which is oil produced from a property which began producing after 1978. Accordingly, under the windfall profit tax, the amount of windfall profit subject to tax is primarily determined by the character of the property from which it is produced.

In general, transfers of producing properties do not alter the tax status of oil produced from those properties. Indeed, certain transfers of producing properties may result in the loss of the independent producer preference for the transferee. The net income limitation (which is designed to apply the tax only to properties where income exceeds expenses) is the only provision in the tax that might be affected by an increase in an acquiring taxpayer's basis in property. However, that provision specifically provides that for purposes of calculating the expenses attributable to a property, the transferee is required to use the transferor's basis in property. Thus, for windfall profit tax purposes, the Treasury is indifferent to the transfer of assets among taxpayers. The tax burden is the same on the transferee as it would be on the transferor.

IV. Summary

In conclusion, the current tax rules would not appear to be propelling the recent flurry of oil corporation acquisitions. We do not believe that Congress should amend the tax laws for the purpose of discouraging these mergers. Nevertheless, we look forward to working with the Subcommittee should it determine as a result of these hearings that improvements in the tax laws are appropriate without regard to whether current law serves as an incentive to oil corporation mergers.

This concludes my prepared remarks. I would be happy to respond to your questions.

STATEMENT OF HON. J. STEVEN GRILES, DEPUTY ASSISTANT SECRETARY, LAND AND MINERALS MANAGEMENT, DEPARTMENT OF THE INTERIOR

Mr. GRILES. Mr. Chairman, I would like to pick up on a point that my colleague from Energy has made and that is that S. 2362 is an attempt to discourage mergers. The legislation imposes upon what we think are the basic purposes of the Mineral Leasing Act and the Outer Continental Shelf Lands Act which are to establish the policies and procedures for managing mineral resources onshore and offshore Federal lands.

S. 2362 has little relationship to those policies and procedures. Specifically, the development of most of our oil and gas deposits on Federal lands requires rights-of-way from the Secretary of the Interior for the transportation of the oil and gas. This bill, as we understand it, would prohibit that. The logical communitization and unitization agreement that industry must enter into would be prohibited and, therefore, development of oil and gas in fact could be stymied and not encouraged.

Another point I would like to make, Mr. Chairman, is we believe that a concern of those who introduced this bill is exploration. That is, the Senator from Alaska has made good points: That the leasing moratorium contained in the Department of Interior's appropriation should be removed; and that the legislation imposing consistency requirements for CZMA should not be enacted. These kinds of inhibiting factors, we believe, have greater impact on the Nation's ability to explore for oil and gas.

We oppose this legislation. We would encourage the removal of the moratoriums and the removal of the other factors which have inhibited oil exploration and resulted in decreased drilling over the last 3 years.

[The prepared statement of Mr. Griles follows:]

STATEMENT OF J. STEVEN GRILES, DEPUTY ASSISTANT SECRETARY, LAND AND MINERALS MANAGEMENT, UNITED STATES DEPARTMENT OF THE INTERIOR, BEFORE THE SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES, COMMITTEE ON ENERGY AND NATURAL RESOURCES, UNITED STATES SENATE, ON S. 2362, A BILL "TO AMEND THE MINERAL LANDS LEASING ACT OF 1920, AND FOR OTHER PURPOSES."

Mr. Chairman and Members of the Committee: I appreciate the opportunity to appear before the Subcommittee on Energy and Mineral Resources to discuss the effect that S. 2362 may have on America's mineral leasing programs and energy supply.

Although after much debate, the Senate indicated its opposition to legislation which would prohibit mergers, S. 2362 would impose constraints in the marketplace which would seriously affect the business opportunities of the oil companies which hold nearly 100 percent of the Nation's energy resources.

The stated purpose of S. 2362 is to prohibit parties to a merger consummated after February 28, 1984, and prior to six months following the date of the bills enactment from having access to the oil and gas resources on Federal lands. This restriction would apply to "any person who, individually or together with his affiliates, owns or has an interest in, ten million barrels or more of proved reserves of crude oil, natural gas liquids equivalents, or natural gas equivalents." In effect, S. 2362 would attempt to discourage mergers by imposing restrictions on the availability of Federal leases and rights-of-way. The implied objective is to "encourage" companies to seek reserves on U.S. lands rather than through corporate takeovers.

The basic purpose of the Mineral Lands Leasing Act (MLA) and the Outer Continental Shelf Lands Act (OCSLA) is to establish the policies and procedures for managing the mineral resources of onshore and offshore Federal lands. S. 2362 has little relationship to those policies and procedures. The policies and procedures of the MLA and OCSLA are designed to encourage development of, and access to, public mineral resources. S. 2362 is designed to limit access to public mineral resources. The Administration firmly believes that oil merger legislation is both unnecessary and counterproductive.

Development of most oil and gas deposits on Federal lands requires rights-of-way from the Secretary of the Interior for transportation of the oil and gas. These rights-of-way are required both onshore and offshore. Under the provisions of S. 2362, a company would be precluded from developing its existing leases, which require a right-of-way, if it were to merge during the period covered by the bill. Development of the leases would require that they be sold to a company to which the Secretary was not precluded from issuing a right-of-way.

Additionally, companies which merge during the stated time period would be forever banned from acquiring the rights to explore and develop Federal lands. Thus, affected companies would be forced to limit their future activity to private or State lands within the United States or lands of foreign countries. Rather than encouraging the exploration for, and development of, new domestic reserves, S. 2362 will, most likely, have the opposite effect. In fact, the bill may encourage companies to increase their exploration activities abroad.

Enactment of S. 2362 would, therefore, have negative impacts upon both our international energy supply and our national security.

Although there is much debate regarding the causes of the recent oil company acquisitions, it is clear that many positive effects may ensue. Mergers may permit oil and gas reserves to be acquired and produced by more efficient companies. The acquiring company, in many instances, will be able to eliminate much of the unneeded overhead which adds substantially to the cost of production but does little to increase the rate of production.

It can be argued that placing reserves under more efficient management will stimulate exploration, rather than limit it. Some mergers improve efficiency and competitiveness of survivor firms, thereby improving cash flows and profits. Since exploration is seldom financed by debt, the stronger the company, the greater its ability to allocate larger exploration budgets. In fact, a recent study of oil and gas acquisition activity during 1979 - 1980 by the Federal Trade Commission found no substantial evidence that increased oil merger activity significantly diverted capital from exploration and development of energy sources. The study concluded that crude oil exploration and production generally increased during the period of increased oil merger activity.

A specific example is in the Shell acquisition of Belridge:

- o Shell acquired Belridge (1979). Belridge had extensive reserves but no access to technology and could not finance huge development expenditures output per day from Belridge oil fields more than doubled as a result of the merger.

Another issue often raised is the effect of oil and gas company mergers upon the competitiveness of the industry. Here it must be remembered that the oil and gas industry is less concentrated than many other major industries such as steel, automobiles, and rubber.

The top four petroleum companies control less than 30 percent of domestic oil and gas reserves; the top 30 firms control less than 65 percent of all oil and gas reserves. This compares with top four firm concentration ratio of 93 percent for transportation vehicles and 70 percent for rubber.

In addition, statutes are aleady codified which address the issue of competition and monopoly control of major industries. For those cases where a proposed merger might have negative impacts upon competition, Section 7 of the Clayton Act and the 1976 Hart-Scott-Rodino amendments to that statute provide the Department of Justice and the Federal Trade Commission with ample authority to examine, and if necessary act upon, proposed merger activities.

The implied objective of S. 2362 is to encourage the discovery of new domestic reserves. This legislation, however, does nothing to ameliorate the negative circumstances which continue to raise the costs of exploration. The fact is that nationwide, less exploration is occurring because the price of oil has dropped while drilling prices have risen sharply. At the same time, and perhaps more importantly, due to prohibitions against exploration in prime areas of industry interest, there are fewer good prospects and fewer large reserves to be found.

Specifically, the leasing moratoria contained in the Department of the Interior's Appropriation Act force exploration and development away from some areas where major fields have been found and into higher cost frontier areas, therefore reducing exploration, instead of allowing the lowest cost areas to be explored first. The removal of these moratoria and elimination of regulatory impediments would do much more to encourage exploration for U.S. oil and gas reserves than the provisions of S. 2362.

In summary, the Department would be happy to support legislation that would encourage the discovery of new domestic oil and gas reserves. However, for the reasons I have already stated, the Department of the Interior does not believe that S. 2362 is consistent with that objective. Accordingly, we cannot support the enactment of S. 2362.

STATEMENT OF HON. DOUGLAS H. GINSBURG, DEPUTY ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. GINSBURG. Thank you, Mr. Chairman. I have a statement that has been submitted for the record. I will summarize it very briefly.

Let me say first on behalf of the Department of Justice and the Antitrust Division, we appreciate this opportunity to appear and address the important issues raised by S. 2362 and related bills.

This has been our first opportunity in a hearing to expand on the statement issued by the Attorney General when these issues were being considered in the Senate. That statement was to the effect that legislation of this sort is both unwise and unnecessary, and I would like to expand on our reasons for that position for just a moment or two.

The antitrust laws, in our view, are fully adequate to deal with such competitive problems as particular mergers may present now or in the future. I say particular mergers, because many mergers in our view are procompetitive. The possibility of a merger taking place means that incumbent management may be stimulated by the threat of potential takeover to do as good a job as possible in maximizing the value of its firm.

The possibility of a merger promotes free entry and exit into the industry and may improve the allocation of resources so that complementary assets and technologies can be combined and recombined to achieve new efficiencies.

We are fortunate, I think, in that our antitrust laws do not categorically ban mergers in particular industries or merger in involving firms of a certain size, but rather those laws call for a case-by-case analysis to be performed by either the Department of Justice or the Federal Trade Commission so that these agencies can identify any competitive consequences of particular mergers and prevent those which should be prevented.

The Department of Justice has not investigated the most recent oil company mergers that have perhaps stimulated this series of hearings. The Federal Trade Commission has done that and, therefore, I will not address the specifics of those transactions. But I would like to make some brief observations that are relevant to those transactions.

First, it is our view that absolute size is entirely irrelevant to the determination of the likely competitive effects of a proposed merger.

Second, it is our view that no recent oil company merger that has been consummated threatens competition or the exploration for, or production of, crude oil, as those are not highly concentrated industries.

Third, competition problems that have arisen, or are likely to arise, in connection with those mergers have been and are likely to be seen in narrow product markets or in particular geographic locales. The antitrust laws are fully adequate to deal with issues of this sort.

Senate bill 2362 would disregard the very basic premise of our antitrust laws, which is that only unreasonable restraints on competition should be barred. The practical effects of the bill would be to prevent or penalize mergers, many of which would effectively enhance the efficiency of the companies involved, as well as mergers that the antitrust laws might prohibit or which could be approved with certain restructuring.

The argument for an indiscriminate bar to mergers in this industry, or in any industry, seem to be misconceived and misplaced. In particular, the argument that these mergers divert capital from exploration to share purchases seems to us to focus incorrectly on the few large companies that are parties to these mergers rather than on the overall exploration activities of the industry.

We see no reason to think that worthwhile exploration opportunities will go unexploited regardless of whether particular companies are able or willing to participate in them.

Finally, we believe that proposals of this sort misconceive the way in which efficient capital markets operate. Mergers enable parties who hold shares in target firms to exchange those shares for cash or securities in the acquiring firm. They do not take the investment out of the capital markets; they simply change the character of that investment.

Halting transactions of this sort will not affect exploration activity. It will simply inhibit the efficient operation of our capital markets, which would be an extremely unfortunate result.

Thank you.

Senator WARNER. Thank you.

[The prepared statement of Mr. Ginsburg follows:]

Department of Justice

STATEMENT OF

DOUGLAS H. GINSBURG
DEPUTY ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

BEFORE THE

SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

CONCERNING

S. 2362 AND MERGERS IN
THE OIL INDUSTRY

APRIL 10, 1984

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to present the views of the Department of Justice on S. 2362, and more generally on the subject of mergers and acquisitions in the petroleum industry. Before discussing this bill, I believe it would be useful to describe generally the role of the antitrust laws in ensuring that the petroleum industry remains as competitive as possible.

The structure and performance of the petroleum industry is a matter of vital importance to the national economy. Accordingly, the Antitrust Division has devoted significant enforcement resources to this industry in recent years. For example, the Division has conducted criminal investigations of retail price fixing of gasoline, which have resulted in convictions and substantial fines of guilty parties. Our efforts in this area are continuing. In addition, we have reviewed several mergers in the industry--most notably, DuPont's acquisition of Conoco and Mobil's proposed acquisition of Conoco. We also review proposed leases of oil and gas properties by the Department of the Interior to ensure that leases do not have significant adverse competitive effects. We have participated extensively in regulatory and judicial proceedings concerning oil pipeline rate regulation, and we are now completing an analysis of interstate petroleum pipelines. In the course of these efforts, we have examined many regional and local markets in areas such as petroleum refining, pipelines, and gasoline wholesaling and retailing.

As a result of our extensive involvement with the petroleum industry, we are convinced that the antitrust laws are fully adequate to ensure that it will remain a competitive one. For that reason, we strenuously oppose this legislation and similar efforts to single out this industry for an especially restrictive approach to corporate mergers.

Our opposition to this legislation is based in part on a recognition of the important role that mergers play in the economy. In a free market economy such as ours, mergers are likely to foster improved management, freer entry and exit, and improved allocation of resources. If a firm is poorly managed, the firm will be operated less efficiently than it otherwise might be, and thus the price of its stock will fall below the level that it could be expected to reach with competent management. The gap between current and attainable price makes the firm an attractive takeover candidate. The effect of a takeover in these circumstances is beneficial for the economy, leading to the reallocation of poorly managed corporate assets to more efficient managers.

An active merger market lowers entry and exit barriers. If a firm seeks to enter a market or to increase its ability to compete in a market where it already makes sales, it may be less costly, and perhaps even essential, to enter or expand through merger than through other means of acquiring the requisite assets. A "merger market" that is not unreasonably encumbered also provides an efficient means for entrepreneurs to realize the maximum amount for their efforts when they choose to exit a business. In addition, mergers may be far less costly than bankruptcy and other forms of reorganization when a firm is financially distressed.

Finally, firms often can obtain needed assets through mergers more efficiently than if they sought to obtain them by other means. Mergers allow firms to combine complementary assets and production technologies and to achieve economies of scale. Under these circumstances, mergers produce important efficiencies, shifting assets to those who value them most.

Because of these important benefits, we have wisely avoided imposing any general prohibitions on particular classes of mergers. Instead, the antitrust laws, specifically Section 7 of the Clayton Act, prohibit mergers only when there is some clear indication that they would be likely substantially to lessen competition and thereby create a threat of artificially increased prices that harm consumers.

In analyzing the likely competitive effects of proposed mergers or acquisitions, including those involving energy firms, the Antitrust Division applies the principles outlined in our 1982 Merger Guidelines. Specific product and geographic markets involved in proposed transactions are identified and the merger's effects on market concentration are measured. The merger's likely competitive effects in those markets are assessed, taking into consideration the ability of actual or potential competitors to respond to post-merger attempts in the industry to raise prices or reduce output.

The Department's Merger Guidelines spell out in greater detail the analysis the Division employs in this process. While these Guidelines have worked well, we are at present in the process of reviewing them carefully to determine whether there are areas in which they could be fine-tuned or clarified to reflect our experience using them since they were revised two years ago.

The Department has and will continue to challenge those mergers that are likely significantly to threaten competition. If particular competitive problems associated with proposed mergers can be solved through divestiture of certain assets, the Department is generally willing to allow the merger to proceed after appropriate divestiture has taken place or, in limited circumstances, after the merging parties are legally bound to divest the necessary assets.

As you may be aware, the Department of Justice shares merger enforcement responsibility with the Federal Trade Commission. That agency, rather than the Department, has reviewed most of the recent mergers involving large energy firms. The Director of the FTC's Bureau of Competition has provided a detailed explanation of the FTC's evaluation of recent oil company mergers under the antitrust laws. 1/ I will not comment on the specifics of FTC enforcement actions regarding particular merger proposals, except to note the Department's general agreement with both the approach outlined, and, in particular, three specific points made by the Director:

First, the absolute size of companies involved in a merger has no bearing on its likely competitive effects. The important question in evaluating any merger is the effect of the merger in properly defined markets. There is little direct correlation between such effects and the absolute size of mergers.

Second, none of the recent mergers involving petroleum companies has threatened competition in the exploration for, or production of, crude oil. Contrary to popular misconceptions, this portion of the petroleum industry is not highly concentrated on either a national or an international basis. In fact, in recent years there has been a substantial decline in the ability of the major international oil companies to control the supply or price of petroleum in world markets, as control over production

---

1/ Hearings Before the Subcomm. on Fossil and Synthetic Fuels and Subcomm. on Commerce, Transportation, and Tourism of the House Comm. on Energy and Commerce, 98th Cong., 2nd Sess. (1984) (statement of Timothy J. Muris, Director, Bureau of Competition, Federal Trade Commission).

capacity has moved from the oil companies to foreign governments. This shift in control largely alleviates any concern about the size and economic power of oil companies.

Third, the competitive problems that have arisen from recent oil company mergers have occurred in relatively narrow product markets and in regional or local geographic markets. Such problems are easily identified and remedied. For example, the recent Texaco-Getty merger was not provisionally approved by the FTC until the merging parties agreed to appropriate divestiture.

Thus, recent mergers in the oil industry, as restructured to avoid competitive problems, have not resulted in significant increases in market concentration. The Department and the Commission will continue to examine proposed transactions in this industry under the antitrust laws to determine whether they are likely to result in unacceptably high levels of concentration. If so, they will be challenged, in whole or in part, to prevent such a result.

Proposals to prohibit oil company mergers, either permanently or temporarily, sharply depart from the premise underlying the antitrust laws that only unreasonable restraints of trade should be unlawful. For example, S. 2362 would prohibit any party to a merger consummated after February 27, 1984, and prior to six months following its enactment who is a "substantial energy reserve holder," 2/ from receiving a lease or right-of-way pursuant to the Mineral Lands Leasing Act and the Outer Continental Shelf Lands Act. This proposal would effectively prevent many such companies from participating in a merger. Moreover, such proposals would prohibit all mergers of qualifying size in the industry, without regard to whether they may be demonstrably procompetitive or anticompetitive, thus substituting a rule of per se illegality for the reasoned approach of antitrust analysis. The antitrust laws, however, are fully adequate to address and prevent mergers in this--or any other--industry that threaten to impair competition. At the same time, those laws ensure that the government will not interfere with mergers that pose no significant threat to competition and that may have significant efficiency-enhancing effects that will permit the combined firms to compete more effectively and thereby benefit consumers.

The primary argument made in support of indiscriminate anti-merger proposals is that mergers divert capital from exploration budgets to a hunt for cheaper reserves on Wall Street. This argument, however, focuses on the activities of a few large firms and ignores the fact that there are hundreds of

---

2/ A "substantial energy reserve holder" is defined as any party who owns or has an interest in ten million barrels or more of reserves.

firms of varying size engaged in exploration for crude oil. There is no reason to believe that the industry as a whole will fail to pursue valuable exploration opportunities.

More importantly, the argument rests on a misconception of the way investment decisions are made in a free market economy. Capital is allocated on the basis of numerous independent decisions of a multitude of companies facing a multitude of possible investment decisions. Capital will be invested in petroleum exploration, or in any other business activity, in proportion to expected returns. Expectations concerning petroleum exploration have shown a natural tendency to rise and fall over time. Oil prices, domestic reserve prospects, and drilling and recovery costs all contribute to exploration investment decisions. The fact that, at present, oil exploration activity is somewhat below the level reached in late 1981 is not, in and of itself, a reason for concern. There have been many significant changes in the industry since that time, and it is therefore hardly surprising that private firms currently are less willing to invest in oil exploration activities than they have been in the past.

In any event, merger activity will probably not adversely affect overall levels of exploration and production because the critical variables considered in making exploration decisions are unaffected by mergers. Apparently, some fear that if an oil company borrows in the capital markets to finance its acquisition of another oil firm, this borrowing will tend to deplete the pool of capital available for exploration. This fear is unfounded. An acquisition moves capital from one group in the capital market to another--the latter being the shareholder of the acquired firm. There is no empirical or theoretical reason, however, to believe that the group that receives the proceeds is going to consume all or an overwhelming part of those proceeds rather than reinvest them in the capital market. In other words, in a merger capital moves within the capital market; very little disappears from the market. Hence, the size of the capital pool will not substantially diminish. Indeed, there is nothing about consummating a merger that changes the profitability of oil exploration opportunities. Therefore, since mergers leave exploration opportunities and the amount of loanable funds essentially unchanged, mergers create insignificant impediments to the flow of capital into potentially profitable exploration prospects. Thus, prohibiting or restricting merger activity is not a viable means of increasing exploration for oil.

Moreover, the bill's prohibition of merging companies from participating in lease sales is counterproductive. If companies do merge in spite of the leasing prohibition, the result would be a reduction, in each instance, of a bidder from the number of firms capable of finding and producing oil on public land. The likely effect of the penalty would be a reduction both in competition for mineral leases and for future exploration and production. Thus, the bill's effects would be to reduce--rather than hold stable or increase--the likely exploration activities of firms in the petroleum industry.

Aside from this obvious lack of benefits, a petroleum merger prohibition is likely to have seriously adverse effects on competition, and, ultimately, consumer welfare. If the threat of takeover by another petroleum firm is removed, the pressure on the management of domestic petroleum companies to be vigorous, to be cost conscious, and to be innovative, will be reduced. In addition, entry and exit barriers would be increased artifically to the detriment of competition and efficiency. Stockholders could likewise suffer because assets could not be shifted to those who value them most.

A petroleum merger prohibition might also deny companies the most efficient means for matching complementary assets to increase their combined output. In the petroleum industry, companies at adjacent vertical stages may foresee real benefits to combining complementary expertise or, if both are at the same level, may foresee real economies of scale from consolidation. For example, a company with highly efficient production technology may take over a company that is an inefficient producer but has substantial oil reserves. Although no new reserves are found, such a merger may greatly benefit the economy because the combined firm may now be capable of getting existing reserves to consumers at much less cost to society. Similarly, the larger size and broader base of expertise that results from a merger might enable the merged firm to undertake a risky but potentially lucrative exploration opportunity that neither of the predecessor firms would have undertaken alone.

In sum, the current spate of merger activity in the petroleum industry should be viewed as a response to free market forces. If some of these mergers appear to be anticompetitive, existing antitrust laws provide adequate remedies; if some of them prove to be unsound business decisions, the discipline of the marketplace can and should be relied upon to remedy the situation. In either event, there is no need for special anti-merger legislation directed at the petroleum industry or for other forms of governmental interference in the market.

Mr. Chairman, that concludes my prepared remarks. I would be happy to respond to any questions you or other members of the Subcommittee may have.

STATEMENT OF HON. TIMOTHY J. MURIS, DIRECTOR, BUREAU OF COMPETITION, FEDERAL TRADE COMMISSION

Mr. MURIS. Thank you, Mr. Chairman. I appreciate the opportunity to appear here today to discuss this important issue. As I am sure you are aware, a substantial part of our antitrust work at the FTC involves reviewing mergers to assure that they do not violate the antitrust laws.

The Bureau of Competition, of which I am Director, has for several years maintained a separate Petroleum Division, which consists of antitrust attorneys and other professionals who specialize in the petroleum industry.

I want to briefly make three points and ask that my testimony be put in the record. First, I want to discuss our oil-merger study. Second, I want to discuss our specific oil-merger cases. Third, I want to discuss briefly competition at the crude oil level.

Turning to our 1982 petroleum-merger study, that study was done after Congress asked us to perform such a study. It was finished in September 1982, is 300 pages long and it contains several conclusions relevant to the hearing this morning.

First, petroleum mergers occur for a variety of reasons, including wider use of enhanced-oil-recovery techniques; divergent expectations concerning future crude oil price movements; the phased decontrol of crude oil; the imposition of the windfall profits tax; and corporate income tax provisions such as those permitting an increased basis of acquired assets and redepreciation of assets for tax purposes. Second, the Commission concluded in the oil-merger study that it did not believe that acquisitions occurring in the period studied adversely affected petroleum prices or availability of supply. Third, the study found no substantial evidence that increased oil merger activities significantly diverted capital from exploration and development of energy sources. Indeed, the study found that crude oil exploration and production generally increased during the period studied. Fourth, the Commission concluded that most geographic markets at the various levels of the petroleum industry were not highly concentrated, that mergers generally increased concentration levels only slightly, and that such increases did not appear to have endangered the substantial competition the commission found to exist in most aspects of the petroleum industry. Finally, and perhaps most pertinent for the subcommittee's present deliberations, the Commission recommended against any legislative moratorium or ban on oil company mergers.

Turning to the second point I wish to make, concerning our enforcement activity regarding oil mergers, we have had three cases, Mobil/Marathon, Gulf/Cities Services, and Texaco/Getty. Let me summarize the common theme among them.

First of all, each involved a major, vertically integrated petroleum company that attempted to acquire a smaller, so-called second-tier firm, primarily to gain control over the latter's crude oil reserves. Second, in each case, the Commission concluded the proposed merger raised substantial anticompetitive concerns that warranted enforcement action. Third, however, none of the competition problems were caused by or even related to the overall size of the company. Fourth, each of the problems affected only a relatively small identifiable region of the country. Fifth, each problem pertains to only one or at most a few of the numerous products that a large integrated oil company markets. Sixth, the mergers created no antitrust problems involved in the discovery and production of crude oil. The Texaco/Getty case was different from the other two in one important sense. Texaco was willing to cure the problem. When firms are willing to cooperate, our standard practice has always been to attempt to obtain a consent agreement to solve the problem. And that is what we did in the Texaco/Getty matter. We obtained and provisionally accepted a precise, focused consent agreement.

The public comment period on the consent agreement extends until May 7, at which time the Commission will assess the public comments to make its final determination. The consent agreement requires the sale of two refineries and one pipeline, the sale of considerable marketing assets—wholesale terminals and gas stations—and the sale of crude oil on the west coast to certain independent refiners. The total value of the divestiture runs into the hundreds of millions of dollars, and the crude oil is valued at $3 billion over the next 5 years.

The final point I want to discuss concerns increased crude oil concentration. There have been some people who have expressed concern over these oil mergers because of an increase in concentration in the crude oil level. If you look, however, at the statistics at that level, you will see that in terms of crude oil reserves and crude oil production, it is one of the least concentrated of the major industries in the United States. Whether you use the Herfindahl index of the 1982 Justice Department guidelines, or four firm concentration of the earlier guidelines, you find that under either——

Senator WARNER. Mr. Muris, we have a practical problem. The chairman is going to attend the services. Could we kindly interrupt your testimony so the chairman can ask questions.

The CHAIRMAN. I apologize, but I did have one question I wanted to ask Mr. Boggs and Mr. Griles. There has been some concern expressed that in some quarters that large oil companies acquire reserves beyond their immediate needs and just sit on them and don't develop them. Due diligence would require Federal leasing as an example.

Can you tell me whether an antimerger legislation would affect the acquisition of reserves or the question of would it have an effect on whether an oil company would be more or less likely to hold reserves in excess of immediate requirements?

Mr. GRILES. Mr. Chairman, the Minerals Leasing Act does have prohibitions on acreage limitation that restrict the number of acres a company can hold onshore. In that regard each of the companies involved in merger activities will be reviewed to assure that they do not exceed that limitation under the law.

If they are in excess of that limitation, we would give them notice. They would have 6 months to dispose of the excess limitation.

The CHAIRMAN. Aside from the question of how you deal with that in your rules and regulations, would the merger or antimerger activities affect the decisions made by oil companies in a way that would measurably affect the reserve holdings?

Mr. BOGGS. If I can address that, perhaps what you have in mind is that it would appear to us that the decision by any oil company, as indeed any asset holder, of how much to hold in inventory is going to depend on their view of the long run future of that industry. Therefore, presumably, since oil companies are not charitable institutions, they are going to try to maximize their revenue over the future.

Obviously, if you have legislation that says we are going to stop you from acquiring reserves, it could make the merger more difficult, but in terms of the view of what is economical for the future, I do not see that it should affect it either way.

The CHAIRMAN. Would it affect the decisions of other people looking at a company with respect to—the target company so to speak, with respect to its own or held reserves in relation to its drilling program and its recovery schedules?

Mr. BOGGS. If one is not allowed to sell what one has found in a gross basis, it is going to make you less likely to want to hold it.

The CHAIRMAN. Would it also be true since one of the, as was pointed out by one of the members of the committee, that a company that needs reserves may find it more economically efficient to merge or take over a company that has reserves, therefore, a company that has a large block of reserves becomes a target for such an action or the likely partner in a merger. But to the extent that we make that impossible, it may lock in those situations to which critics might point to that in fact some companies might have reserves larger than is perceived to be necessary, at least by other people.

Mr. BOGGS. It is correct that if a company has for whatever reason been successful in finding a large amount of reserves which gives it a very long life index and which perhaps is having some difficulty in producing at an optimum rate, if you cannot have a merger to allow it to be produced at a higher rate, as, for example, the case of Shell and Belridge, then that would lead to excess reserves.

I think it is also important that it is going to mean that people are less likely to want to discover reserves if they cannot sell them en bloc.

The CHAIRMAN. Mr. Chairman, I apologize to the witnesses and the panel for interrupting the testimony. I appreciate your willingness to do that as I have to be absent.

Mr. MURIS. Thank you, Mr. Chairman. Let me finish the point I was making about competition at the crude oil level. In terms of crude oil reserves and crude oil production there are no problems, by traditional antitrust standards. The tables that are in my testimony on pages 11 and 12 indicate, even using the highest concentration level, which is crude oil reserves, the Herfindahl level is barely above 300, well below the 1,000 number that is the cut-off in the 1982 guidelines for antitrust concerns. The four-firm concentration level is 30 percent, well below the 1968 highly concentrated guideline level of 75 percent. Thus, whatever standards you use, if you are looking at that crude oil level, there is no problem.

Let me finish by noting that this conclusion does not mean that when one goes downstream in to refining or transportation or into marketing that there cannot be antitrust problems. In fact, the commission has found downstream problems in the cases it has reviewed.

Thank you very much.

[The prepared statement of Mr. Muris follows:]

PREPARED STATEMENT

OF

TIMOTHY J. MURIS[*]
DIRECTOR
BUREAU OF COMPETITION

FEDERAL TRADE COMMISSION

BEFORE THE

SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES

OF THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITES STATES SENATE

April 10, 1984

Mr. Chairman and Members of the Subcommittee: I appreciate the invitation to appear here today to discuss the issue of mergers in the petroleum industry. As Director of the Federal Trade Commission's Bureau of Competition, my focus will be upon the competition and antitrust implications of petroleum mergers and acquisitions, that is, their effect upon the price and availability of petroleum products for the American consumer. My views are those of the Bureau of Competition, and do not necessarily represent those of the Commission or of any individual Commissioner.

A substantial portion of the FTC's antitrust work involves reviewing corporate mergers and acquisitions[1] to assure they do not violate federal antitrust laws. The FTC's Bureaus of Competition and Economics have developed considerable expertise in analyzing competition issues involving the petroleum industry. The Bureau of Competition, for example, has for several years maintained a separate Petroleum Division, consisting of antitrust attorneys and other professionals who specialize in analyzing competition issues in the petroleum industry. The agency's staff has developed its expertise over many years, in several cases and investigations. These matters include the Commission's Exxon case against the major petroleum companies (dismissed in 1981) and the oil company mergers that have occurred over the past few years.

---

[*] The opinions expressed are solely those of the author and do not necessarily reflect the views of the Federal Trade Commission or any individual Commissioner.

[1] As a convenient shorthand, I will henceforth refer only to "mergers."

Given this considerable petroleum industry experience, it is not surprising that the Commission is performing the government's antitrust review of the current oil mergers -- Texaco/Getty, Socal/Gulf, and Mobil/Superior. As the Subcommittee is aware, the Commission has provisionally accepted a consent agreement remedying potential antitrust concerns raised in the Texaco matter. The Commission's proposed remedy is now on the public record, and interested persons will have until May 7 to file written comments.

The Commission's staff is presently in the midst of its intensive review of the proposed Socal and Mobil transactions, however. Therefore, it is premature to attempt any detailed discussion of those mergers' likely impact. I will, nevertheless, be happy to discuss both the procedures the Commission is using to review those mergers and the antitrust concepts relevant to petroleum mergers in general.

In this testimony, I first discuss our 1982 study of oil mergers, one of the most detailed and comprehensive studies published on the subject. I next evaluate our past enforcement regarding oil mergers, in particular the recent provisionally accepted consent agreement in the Texaco/Getty matter. Finally, I discuss briefly the issue of increased concentration in production of crude oil.

I. The 1982 Petroleum Merger Study

In January, 1982, eight congressional leaders from both houses of Congress asked the Commission to investigate the impact of mergers and acquisitions involving large petroleum companies. The Commission directed its petroleum industry experts to conduct an in-depth, exhaustive review of numerous issues involved in petroleum industry acquisitions. Just 19 months ago, in September 1982, the Commission forwarded to Congress its 300-page report entitled, "Mergers in the Petroleum Industry," presenting its analysis and conclusions.[2] This "Oil Merger Study" reached a number of significant conclusions regarding oil mergers that are relevant to the issues currently before Congress. It may therefore be helpful to summarize these conclusions.

---

[2] Commissioners Pertschuk and Bailey attached separate statements to the report noting, inter alia, that they did not agree with all the conclusions reached in the report.

First, oil industry acquisition activity did increase during the 1979-1980 period studied, although a few large transactions accounted for much of the increase. (As I discuss below, heightened activity has again resurfaced in recent months.) Second, petroleum mergers occur for a variety of reasons, including: wider use of enhanced oil recovery techniques; divergent expectations concerning future crude oil price movements; the phased decontrol of crude oil; the imposition of the windfall profits tax; and corporate income tax provisions such as those permitting an increased basis of acquired assets, and redepreciation of assets for tax purposes.

Third, the Commission concluded in the Oil Merger Study that it did not believe that acquisitions occurring in the period studied adversely affected petroleum product prices or availability of supply. Fourth, the Oil Merger Study found no substantial evidence that increased oil merger activity significantly diverted capital from exploration and development of energy sources. Indeed, the Study found that crude oil exploration and production generally increased during the period of increased oil merger activity. (Of course, this conclusion was based on evidence available at the time, and we will continue to study this and other issues as we evaluate current merger activity.) Fifth, the Commission concluded that most geographic markets at the various levels of the petroleum industry were not highly concentrated; that mergers generally increased concentration levels only slightly; and that such increases did not appear to have endangered the substantial competition the Commission found to exist in most aspects of the petroleum industry.

The remaining conclusions of the Oil Merger Study appear especially relevant to the Subcommittee's deliberations. The Commission concluded, sixth, that transaction costs -- including investment banking and legal fees -- for most petroleum acquisitions ranged from one-half of one percent to one percent (and in some cases exceeded one percent) of the total purchase price. Seventh, the Commission identified several possible efficiencies that resulted from some petroleum mergers. These include application of technical know-how to increase crude oil production and benefits flowing from revaluations of crude oil reserves.

Finally -- and perhaps most pertinent for the Subcommittee's present deliberations -- the Commission recommended against any legislative ban on oil company mergers. The Commission concluded that:

> Such interference in normal market forces is unwarranted, both because there have been no significant adverse implications on the state of competition in the industry from mergers, and because mergers with significant competitive impact can be satisfactorily examined under Section 7 of the Clayton Act and the 1976 Hart-Scott-Rodino amendments to that statute.[3]

With this Study as a general framework, I will now turn to a brief summary of the Commission's recent investigative and enforcement actions involving petroleum industry mergers. Such a summary is useful to place the current merger activity in context.

II. Recent FTC Actions Against Petroleum Mergers

A. Mobil/Marathon

Perhaps the logical starting point is Mobil's unsuccessful attempt in late 1981 to acquire Marathon. As the Subcommittee will recall, that bid followed an earlier unsuccessful attempt by Mobil to acquire Conoco, which instead became a DuPont subsidiary. The FTC's investigation of the proposed Mobil/Marathon merger revealed significant potential antitrust concerns involving competition in certain "downstream" markets -- those involving the wholesale and retail distribution of gasoline, home heating oil, and certain other petroleum products. The Commission determined that these concerns were too significant to permit the merger to proceed, and filed a preliminary injunction suit to block the merger.

It is useful here to correct a common misconception about the FTC's enforcement action in the Mobil/Marathon case. Some have said that it was a private antitrust suit by Marathon that blocked Mobil's takeover bid, and that the FTC's subsequent action was too tardy and had no effect. Yet, the FTC utilized all of the statutory time period permitted under the Hart-Scott-Rodino premerger notification procedures to allow for an analysis as thorough and as focused as possible. Marathon's private suit certainly played a major role in the eventual success of U.S. Steel in acquiring Marathon. The Commission, however, was ready, willing, and able to litigate its preliminary injunction suit had that proven necessary to prevent the anticompetitive aspects of Mobil's proposed acquisition of Marathon.

---

[3] See FTC Report "Mergers in the Petroleum Industry," supra, at 298.

Another misconception of the Commission's role in Mobil /Marathon arose at hearings last month before the Senate Judiciary Committee. In his prepared statement at that hearing, FTC Commissioner Pertschuk charged that Chairman Miller ignored the "problem that Mobil would not follow Marathon's traditional pattern of supplying independents, particularly gasoline marketers."[4] This is simply inaccurate. Chairman Miller voted to support the theories discussed in the brief filed supporting the Commission's request for a preliminary injunction. In that brief, the Commission discussed in detail the very problem Commissioner Pertschuk accuses the Chairman of ignoring.[5]

B. Gulf/Cities Services

The next major Commission action involving this industry occurred when Gulf Oil Company attempted to acquire Cities Services Company in mid 1982. Once again, the FTC conducted its review under the Hart-Scott-Rodino procedures, and once again the Commission determined that enforcement action was required to forestall anticompetitive consequences. Following the Commission's filing of a preliminary injunction suit, Gulf abandoned its bid to acquire Cities Services. Occidental Petroleum Company -- also one of the smaller, "second-tier" oil companies -- subsequently acquired Cities Services. The FTC closely reviewed that merger as well, concluding it presented no danger of any substantial lessening of competition.

C. Texaco/Getty

The Texaco/Getty merger followed the pattern of the prior two transactions: a "major," vertically-integrated petroleum company attempting to acquire a smaller, second-tier firm, primarily to gain control over the latter's crude oil reserves. And, the FTC once again concluded that the proposed merger raised substantial antitrust concerns warranting enforcement action. (I should note here that, in contrast to the Mobil/Marathon case, two private antitrust suits failed to block the merger.)

The Commission's expertise in the petroleum industry enabled it promptly to pinpoint four antitrust problems. First, the merger raised concerns about competition in the manufacture and transportation of "refined light products" in the northeastern

---

[4] Testimony of Michael Pertschuk, Commissioner, Federal Trade Commission Before the Senate Judiciary Committee (March 15, 1984) at 8.

[5] Commissioners Pertschuk and Bailey noted in separate statements supporting an injunction that they objected to inclusion in that suit of specific reference to particular terms of settlement, not yet agreed upon, that might remove the need for injunctive relief.

United States. These products include gasoline, fuel oil, jet fuel, and kerosene. Second, the merger threatened to reduce competition in the wholesale distribution of gasoline, home heating oil, and diesel fuel to retailers in the Northeast. Third, the Texaco/Getty combination raised a danger of diminished competition in transporting refined light products by pipeline into Colorado. Finally, the merger might result in the demise of independent refiners in California, reducing competition in the already moderately concentrated California refinery market.

Several crucial facts can be gleaned from close scrutiny of these potential antitrust problems: First, none of the competition problems are caused by, or even related to, the overall size of the oil company created by combining Texaco and Getty. Second, each of the problems affects only a relatively small, identifiable region of the country. Third, each problem pertains only to one or at most a few of the numerous products marketed by a large, integrated oil company. Fourth, the Texaco/Getty merger created no antitrust problem involving the discovery and production of crude oil.[6]

The four antitrust concerns identified were serious ones. The Commission's staff of economists and lawyers, however, unanimously concluded that they could be remedied without barring the entire merger. Texaco, for its part, was willing to do so. It is important here to stress two points: first, firms proposing to engage in potentially anticompetitive acquisitions are not always cooperative in working with the Commission to alleviate competitive problems; and second, when such firms are willing to cooperate, our standard practice has always been to attempt to obtain by means of a consent agreement the relief necessary to remedy the perceived antitrust problems.

Thus, following our standard practice in merger investigations, we discussed with counsel for Texaco whether the antitrust concerns could be eliminated. As a predicate for any possible settlement of the antitrust issues, we insisted upon a signed agreement obligating Texaco to maintain Getty as a separate, viable oil concern throughout the public comment period while the Commission assessed whether to give final approval to any consent agreement that was reached. When Texaco agreed to this precondition, negotiations continued on the question of remedying the antitrust concerns.

---

[6] The California problem did not concern the discovery and production of crude oil, even if California is treated as a separate geographic market. Instead, the potential competitive problem we found related to refiners who had built plants designed to use the cheaper, "heavy" crude oil that Getty sold. Although these refineries produce the same products as do refineries using lighter crude, the cost of retooling the refineries to rely on more-expensive, lighter crude is so high that loss of a reliable source of heavy crude over the mid-term (three to five years) could lead to their departure from the market.

Following these negotiations, Texaco agreed to submit to an FTC order that the agency's staff of economists and attorneys unanimously agreed would remedy any possible anticompetitive harm from the merger. As the Subcommittee is aware, a four-member majority of the Commission provisionally accepted that consent agreement on February 13, 1984.

With your permission, I will submit for the record a copy of that consent agreement, together with a copy of the proposed complaint setting forth the Commission's allegations of competitive harm, the hold separate agreement signed by Texaco, and a detailed staff analysis of the antitrust concerns and the relief the Commission obtained.

D. The Texaco/Getty Consent Order

The relief in the consent agreement addresses each of the four potential competitive concerns outlined above. It does so in a precise, focused manner: the Commission's knowledge of the industry enabled it to cut with a scalpel, not a meat cleaver. At the same time, the relief resolves all of the competitive concerns. Both of these propositions are readily apparent from a brief summary of that relief.

To remedy any possible increased incentive Texaco might have to restrict the output of refined light products available in the Northeast, the order requires Texaco to take two significant steps. First, it must divest its Eagle Point, New Jersey refinery to a buyer approved by the FTC. The Commission will review proposed buyers to assure they can operate the refinery as a competitive facility likely to remain in the market. Second, for ten years Texaco must always vote in favor of proposals to expand the Colonial Pipeline. Along with other petroleum firms, Texaco is a co-owner of Colonial, which transports refined products from the Gulf Coast through the Southeast and into the Northeast. These two provisions, working together, will diminish the possibility of supply restrictions in the Northeast.

In addition, the Commission's order requires Texaco to divest its wholesale gasoline terminal operations in six Northeast areas (and a seventh in Colorado). To assure that Texaco could make an adequate divestiture of the wholesale terminals, the order also requires Texaco to divest some 1900 retail gasoline stations that the wholesale terminals supply. Once again, the Commission must approve in advance the buyers of these properties.

This last point merits some elaboration. It is true that Texaco -- on its own initiative and without consultation with the Commission or its staff -- has entered a contract to sell these Northeast wholesale and retail properties to an independent gasoline marketer operating under the "PowerTest" name. Texaco entered this contract in part to reduce its antitrust exposure in a private (and unsuccessful) antitrust suit brought by Pennzoil to block the acquisition of Getty. The Commission has not approved PowerTest -- or anyone else -- as a buyer of any of the acquired Getty assets. After the Commission gives final approval to the consent agreement, Texaco will be required to submit proposed buyers for FTC approval. Interested persons will then have a 30-day public comment period to submit written comments on the question of whether PowerTest or any other proposed buyer should be approved. Among the factors the Commission will consider is whether the buyer is willing and able to maintain the assets as viable properties in competition with those of existing firms. As with other properties to be divested, the Commission will insist upon adequate assurances that the properties will remain competitive.

The third principal provision of the consent agreement requires Texaco to divest Getty's substantial ownership interest in the Chase pipeline, which is one of four pipelines that delivers refined light products into the Denver, Colorado area. Texaco already owns a portion of another of those pipelines, raising an obvious antitrust concern. To prevent Texaco from using its partial control over two of the four pipelines to raise prices to consumers in Colorado, the Commission required Texaco to shed its interest in the Chase pipeline. The pipeline probably could not be sold by itself, however, because it is only valuable in conjunction with the El Dorado, Kansas refinery to which it is connected and which supplies the products shipped to Colorado. Again for the sole purpose of assuring that adequate divestiture could be accomplished, the Commission elected to take the prudent enforcement approach and to also require divestiture of the Eldorado refinery and the associated assets necessary to operate it and supply it with crude oil.

We will pay close attention to the question of whether a proposed buyer of the El Dorado refinery will be willing and able to operate it successfully so that it adds competition to the marketplace, while simultaneously maintaining productive employment for Kansans. In this regard, one factor of particular interest will be whether the buyer will be able to obtain an adequate supply of crude oil and other feedstocks necessary to operate the refinery. The Commission's requirement that Texaco sell crude oil gathering pipelines running from crude oil fields to the El Dorado refinery should go far to assure that goal.

The final substantive order provision requires Texaco to continue to sell so-called "heavy" crude oil to independent California refiners that bought from Getty prior to its merger into Texaco. Those refiners have in many cases made costly adjustments to their refineries to process this unique type of crude oil. The merger raises a concern whether such refiners can continue to obtain a crude supply, because Texaco may have tax incentives, unrelated to the efficient use of the resources involved, to use heavy crude oil in its own West Coast refineries. Such a shift could weaken competition from independent refiners, and might even cause some to leave the market. To prevent such problems, the consent order requires Texaco to continue supplying those current Getty refiner-customers for a 5-year period. By that time offshore sources of heavy crude oil already discovered would be more than ample to eliminate any supply problems the merger might create for independent refiners.

Although the total cost of the assets Texaco is ordered to divest is small relative to the total $10.1 billion cost of the acquisition, it is nonetheless substantial -- running into several hundreds of millions of dollars. (The precise cost of the to-be-divested assets is of course uncertain, because potential buyers need not be arranged until after the Commission gives final acceptance to the consent order.) Further, the Commission's staff estimates that the value of the crude oil Texaco is required to sell to certain independent California refiners will exceed $3 billion over the 5 years the supply obligation will be in place. By any measure, the magnitude of this relief is substantial.

E. Conclusion Regarding FTC Enforcement

Thus, in each of the proposed mergers involving attempted takeovers by a "major" oil company of a second-tier oil company, the FTC pursued enforcement action. Some have apparently forgotten these vigorous actions. Thus, one hears cries that the Commission's allegedly "lax" merger enforcement policy was somehow a driving force behind the latest "big oil" mergers. As noted, the facts belie such claims. If there was a message to be drawn from prior FTC actions, it was that mergers between competing oil concerns would be subjected to rigorous antitrust scrutiny and, if antitrust concerns were found, would be challenged.

Some of the criticism may be due to a fundamental misunderstanding of the competitive nature of the oil industry, particularly at the level of crude oil production. I turn next to this issue.

III. Increased Crude Oil Concentration

One of the most frequent concerns that has been raised in recent days regarding petroleum industry mergers is that they are concentrating the ownership of United States crude oil reserves in the hands of a very few large oil companies. Such concentration is dangerous, it is said, to consumers.

It is useful to step back and place these assertions in perspective. The Commission's 1982 Oil Merger Study concluded, for instance, that the petroleum industry in general -- and the production of crude oil in particular -- is relatively unconcentrated. This conclusion is supported when one analyzes how mergers involving crude oil reserves have historically been treated under the federal government's merger enforcement guidelines.

A. The 1982 Guidelines

In each of the major oil company mergers it has analyzed in the past few years, the Commission has applied the analytical approach detailed in the Commission's 1982 "Statement on Horizontal Mergers" and in the Justice Department's 1982 Merger Guidelines. These guidelines make clear that concentration is a necessary but not sufficient condition before the government will attack a merger. Unless certain specified levels of concentration are reached, the conditions for non-competitive performance in an industry are unlikely to exist. Although there may be a few special problems in crude oil,[7] in general, the concentration level is very low in crude oil. Tables 1 and 2 provide the latest available statistics for crude oil production and reserves in the United States.

---

[7] See FTC Report "Mergers in the Petroleum Industry", supra, at 151-54.

TABLE 1

U.S. CRUDE OIL, CONDENSATE AND NATURAL GAS LIQUIDS PRODUCTION, 1982

(000 Barrels/day)

Company	Production	Percent of Total
Exxon	740.0	7.3
Standard of Ohio	694.9	6.8
Atlantic Richfield	607.4	6.0
Shell	519.0	5.1
Standard of Indiana	409.0	4.0
Texaco	352.0	3.5
Standard of California	332.0	3.3
Gulf	328.7	3.2
Mobil	309.0	3.0
Getty	280.0	2.7
Phillips	260.0	2.5
Sun	212.1	2.1
Union	171.4	1.7
Marathon (U.S. Steel)	160.1	1.6
Occidental	151.0	1.5
DuPont	136.0	1.3
Tenneco	89.1	0.9
Amerada Hess	76.5	0.8
City of Long Beach	70.0	0.7
El Paso	67.2	0.7
Union Pacific	59.4	0.6
Superior	57.3	0.6
Santa Fe	44.7	0.4
Mitchell Energy & Devel.	41.9	0.4
Louisiana Land & Expl.	41.4	0.4
Aminoil (R.J. Reynolds)	39.6	0.4
InterNorth	37.5	0.4
Pennzoil	35.1	0.3
Diamond Shamrock	33.4	0.3
Texas Oil & Gas	33.1	0.3
Others (all smaller than the top 30)	3,810.2	37.4
U.S. Total	10,199.0	100.0
Top 4	2,561.3	25.1
8	3,983.0	39.1
15	5,526.6	54.2
20	5,965.4	58.5
30	6,388.8	62.6
HHI (after Texaco/Getty acquisition)		270

TABLE 2

PROVEN U.S. CRUDE OIL, CONDENSATE AND NATURAL GAS LIQUIDS RESERVES, 1982

(Millions of Barrels)

Company	Reserves	Percent of Total
Standard of Ohio	2,855.6	8.1
Exxon	2,836.0	8.1
Atlantic Richfield	2,561.0	7.3
Shell	2,200.0	6.3
Standard of Indiana	1,660.0	4.7
Getty	1,241.0	3.5
Standard of California	1,202.0	3.4
Texaco	1,045.0	3.0
Mobil	906.0	2.6
Gulf	816.0	2.3
Sun	691.0	2.0
Marathon (U.S. Steel)	606.3	1.7
Occidental	583.0	1.7
Union	523.0	1.5
Phillips	492.0	1.4
DuPont	350.0	1.0
Amerada Hess	260.0	0.7
Tenneco	251.7	0.7
Pennzoil	140.0	0.4
Superior	138.7	0.4
Santa Fe	138.3	0.4
Union Pacific	137.6	0.4
El Paso	136.2	0.4
Aminoil (R.J. Reynolds)	120.9	0.3
Mitchell Energy & Devlp.	111.6	0.3
Southland Royalty	81.8	0.2
Texas Oil and Gas	79.3	0.2
Louisiana Land & Expl.	69.0	0.2
Enserch	61.5	0.2
Kerr-McGee	60.1	0.2
Others (all smaller than the top 30)	12,724.4	36.3
U.S. Total	35,079.0	100.0
Top 4	10,452.6	29.8
8	15,600.6	44.5
15	20,217.9	57.6
20	21,358.3	60.9
30	22,354.6	63.7
HHI (after Texaco/Getty acquisition)		329

The numerical standards embodied in the 1982 Justice Department Merger Guidelines ("Guidelines") use the "Herfindahl-Hirschmann" index, often abbreviated as the "HHI" index. In a nutshell, the likelihood of a government challenge to a merger between competitors is based upon the post-merger HHI index and the size of the HHI change caused by the merger. For example, a challenge is unlikely under any facts when the HHI value after the merger is below 1000 "points". At the other extreme, a challenge is likely when the merger increases the HHI index by more than 100 points to above the 1800 level. Table 3 summarizes these standards.

Applying these enforcement guidelines to the market for crude oil, it can be seen that no merger between competing oil companies is likely to be challenged based on its effects in the overall crude oil market. The HHI measured in terms of U.S. production is only about 270 and in terms of U.S. crude oil reserves is approximately 329.[8] All of these values are well below the 1000 HHI level that normally triggers potential antitrust concern with a merger between competitors.

In 1979, the staff of the House Judiciary Committee's Subcommittee on Monopolies reached a similar conclusion, stating:

> 4. Using a variety of concentration ratio guidelines and empirical estimates, U.S. crude oil production does not appear to be sufficiently concentrated to affect competition adversely.

---

[8] This discussion assumes the United States as the relevant geographic market. See FTC Report "Mergers in the Petroleum Industry," supra, at 149-54.

TABLE 3

DOJ 1982 MERGER GUIDELINES

HHI	ACTION
Post-Merger HHI Below 1000	Unlikely to Challenge
Post-Merger HHI Between 1000 and 1800	
Change in HHI below 100	Unlikely to Challenge
Change in HHI above 100	More likely than not to Challenge
Post-Merger HHI above 1800	
Change in HHI below 50	Unlikely to Challenge
Change in HHI between 50 and 100	More likely to Challenge, depending on other factors
Change in HHI above 100	Likely to Challenge

5. While holdings of domestic crude oil reserves appear somewhat more concentrated than production, reserves concentration does not strongly suggest the existence of market power.[9]

It is important to emphasize that these facts do not mean that large oil companies can merge at will under the antitrust laws. Once one moves "downstream" to refining, marketing, and distribution, significant antitrust problems can exist. Indeed, as explained above, the Commission found such problems in each of the three large oil mergers it has evaluated.

B. 1968 Guidelines

A similar enforcement policy was indicated under what are widely viewed as the more stringent enforcement standards of the (now superseded) 1968 Department of Justice Merger Guidelines. The 1968 guidelines for horizontal mergers applied a set of market-share-based standards to determine whether the Department was likely to challenge a given merger between competitors. Which of three "bright-line" market share tests applied to a given merger depended upon whether the market was "highly concentrated" (then defined as one in which the top four firms accounted for 75 percent or more of sales), "less highly concentrated" (the top four firms having a combined share of less than 75 percent), or experiencing a "significant trend toward concentration".

In terms of the 1968 Guidelines, the overall crude oil market would clearly not fall into the strictest "highly concentrated" category. The top four firms combined have nowhere near a 75 percent market share. Similarly, it is highly unlikely that, despite the recent increase in oil merger activity, the crude oil market could qualify as one having a significant trend toward increased concentration under the definition of the 1968 Guidelines. Indeed, from 1970 to 1982 concentration in crude oil production decreased slightly.

Thus, the applicable standards would be those of the "less highly concentrated" category. Based upon 1982 production figures, only a merger between two of the top five crude oil producers (i.e., Exxon, Sohio, Arco, Texaco, and Shell) or of the top five holders of crude oil reserves (the same firms) would "ordinarily" have been challenged by the Department of Justice under the 1968 Guidelines. Only in a merger involving two of those five firms would both the acquiring and acquired oil company have crude oil market shares of five percent or more.

---

[9] Staff of House Subcomm. on Monopolies, Comm. on Judiciary, 96th Cong., 1st Sess., Interdependence in Domestic Crude Oil: Joint Ventures, Farm Outs, Exchanges, and Gathering Lines, 1 (Comm. Print 1979).

To see this, consider an application of the 1968 Guidelines standards (by which a merger between a firm with five percent or more and competitor with five percent or more will ordinarily be challenged) to the recent Texaco/Getty merger. Texaco, with a 3.5 percent market share in crude oil production, acquired Getty, with 2.7 percent of crude production. If crude reserves were used to measure market shares (in place of production) the result is similar. Getty's share of known crude oil reserves was higher than its percentage of production; its merger with Texaco resulted in Texaco, with 3.0 percent of crude reserves, acquiring Getty's 3.5 percent of crude reserves. Under either measure, the five percent/five percent standard is not met.

It is worth noting that the Federal Trade Commission has abandoned strict reliance on concentration in deciding whether to bring merger cases. In 1982, a unanimous Commission, including members appointed by three different Presidents, wrote that "an increase in the threshhold market shares is clearly justified" and that "consideration of additional market characteristics [beyond market share], entry barriers being the major example, may provide a clearer and more accurate picture of the competitive dynamics."[10]

In any event, under either the more stringent 1968 merger guidelines or the superior 1982 guidelines, the relevant product market that has been cited as most troublesome by some critics of petroleum mergers -- the production of crude oil -- was not sufficiently concentrated in the Texaco/Getty merger to trigger the government's merger enforcement standards.

Of course, in each petroleum merger investigation the Commission will analyze each possible product and geographic market in which the merging firms are competitors -- using the standards of its own Horizontal Merger Statement and the Department of Justice's 1982 Merger Guidelines -- to assess the likely competitive effects of the merger. When it finds competitive overlaps of a magnitude sufficient to endanger competition, the Commission will do what it has done in every petroleum merger it has reviewed: it will take whatever law enforcement action is necessary to prevent injury to competition.

IV. Conclusion

The Commission has developed considerable expertise over the past years in analyzing the competitive impact of mergers in the petroleum industry. In each such merger, it has completed its antitrust review under the Hart-Scott-Rodino procedures and has taken law enforcement action necessary to assure that no unlawful lessening of competition results. The Commission has opposed any merger moratorium legislation as unnecessary to prevent anticompetitive mergers and as an unwarranted interference with market forces. I believe that position remains sound. Thus, the Subcommittee should be advised that, although there may be other policy grounds underlying the adoption of any such legislation, such a measure is neither essential for, nor certain to contribute to, the preservation of a competitive oil industry for the benefit of American consumers.

---

[10] FTC Statement Concerning Horizontal Mergers, at 3 (June 14, 1982).

STATEMENT OF HON. JOHN J. HUBER, DIRECTOR, DIVISION OF CORPORATION FINANCE, SECURITIES AND EXCHANGE COMMISSION

Mr. HUBER. Mr. Chairman and members of the subcommittee, I appreciate the opportunity to participate in these hearings. I have prepared a written statement and request that it be included in the record.

In summarizing my testimony, I would like to make two points. First, the transactions that have prompted these hearings are already covered by the Federal Security laws. These laws are intended to protect investors. Moreover, these laws apply generically and do not vary with the type of industry involved.

The commission in administering these statutes does so in a neutral and evenhanded manner, favoring neither the bidder nor the target.

Second, the commission is currently involved in a process of studying and implementing certain interrelated modifications to the regulatory framework governing tender offers and other controlled transactions. That process is an outgrowth of a study concluded last year by the commission's advisory committee on tender offers and will result not only in rulemaking, but also in legislative proposals.

The current system of regulation covers a wide variety of transactions that may involve a change in control of a public company. The applicability of the Federal securities laws depends on the type of transaction. They vary from open market, privately negotiated transactions, tender offers, mergers, asset transactions and proxy transactions.

Moreover, the change in its control often involves a series of transactions. For example, an open market purchase programs as the first step followed by a tender offer as the second step and concluding with a merger. As takeover techniques have become more and more sophisticated, so too have the relevant regulations.

Referring to the advisory committee on tender offers, their recommendations were divided into six categories. First, economics of takeovers; second, objectives of Federal regulation of takeovers; third, regulation of bidders; fourth, regulation of targets; fifth, regulation of market participants; and sixth, interrelationships of various regulatory systems.

I would just like to highlight the first category, the economics of takeovers. I will not discuss the specifics but they are in my testimony. As to the economics of takeovers the committee concluded and the commission concurred that takeovers are a valid method of capital allocations, so long as they are conducted in accordance with laws deemed necessary to protect the interests of shareholders and the integrity and efficiency of our capital market.

Therefore, the regulatory structure should neither promote nor deter such activity. Further, the commission concluded that tender offers do not distort the capital market.

In addressing the appropriate objectives for Federal regulation of takeovers, the committee found that takeover regulation should not favor bidder or. target companies, that Federal regulations should recognize that change of control transactions occur in a national securities market, that State regulation of takeovers should be combined to local companies and certain regulated industries, that State laws should not be permitted to restrict a company's ability to make a tender offer, that Federal tender offer regulations should not preempt State corporation law or the business judgment law and that Federal takeover regulations should not be used to achieve monetary tax, labor, antitrust, or other objectives.

While agreeing that State law should govern corporations' internal affairs, the commission also believes that shareholders will be better served if the courts give greater recognition to potential conflicts of interest between management and shareholders in change of control transactions.

In summary, with respect to the advisory committee, the commission agreed with 34 of the advisory committee proposals and endorsed 13 with qualifications. Of those supported, 14 will be put out for public rulemaking and 6 would require legislation. The balance do not require formal action.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Huber follows:]

STATEMENT OF JOHN J, HUBER, DIRECTOR, DIVISION OF CORPORATION FINANCE SECURITIES AND EXCHANGE COMMISSION BEFORE THE SENATE SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES - TUESDAY, APRIL 10, 1984

Chairman Warner and Members of the Subcommittee:

I. Introduction

I appreciate the opportunity to appear before the Subcommittee today and to be of assistance in the Subcommittee's study of acquisitions and mergers in the petroleum industry. Transactions that are the focus of the Subcommittee's study can be structured in a variety of forms. The particular application of the federal securities laws will depend on the form that the transaction takes. My remarks will address the current framework of regulations as well as the areas in which legislative and rulemaking changes may occur as a result of recent developments.

The first part of my statement describes applicable provisions of the federal securities laws in the context of a significant stock acquisition or a merger. Because some of the mergers that have received significant exposure involve tender offers, this explanation will pay particular attention to the tender offer provisions of the Williams Act, provisions that were added in 1968 to the Securities Exchange Act of 1934 ("the Exchange Act"). The second part of this discussion addresses the Report of Recommendations of the Commission's Advisory Committee on Tender Offers. This statement sets forth the Advisory Committee's recommendations and the Commission's positions and proposed actions with respect to those recommendations. Chairman Shad and I testified as to these positions and proposed actions before the House Subcommittee on Telecommunications, Consumer Protection and Finance on March 28, 1984.

II. Relevant Federal Securities Laws

The federal securities laws are primarily disclosure statutes, premised on the concept that investors are best protected when full and fair disclosure is made available. In administering these laws, the Commission's principal emphasis is on the protection of investors through disclosure rather than on any substantive regulation of the relative merits of a particular investment opportunity. In the specific area of tender offers, there are certain regulations governing substantive transactional terms, such as length of the offer and withdrawal and proration rights and the "best price" rule. Because the federal securities laws apply equally to all issuers, persons and transactions that come within their scope, the provisions I will discuss are not limited to the petroleum industry.

A. Acquisitions Resulting in More Than Five Percent Beneficial Ownership

Certain recently introduced legislation would place limits on share acquisitions both in the petroleum and the natural gas interstate pipeline industries. 1/ The federal securities laws apply to share acquisitions in essentially two kinds of transactions: (1) an open market or privately negotiated purchase that results in direct or indirect beneficial ownership of more than five percent of a class of equity securities that is registered under Section 12 of the Exchange Act; and (2) a tender offer for securities, either for cash or for securities of the acquiror (a so-called "exchange offer").

1. Open Market and Privately Negotiated Block Purchases That Do Not Involve a Tender Offer

Under Section 13(d)(1) of the Exchange Act and Commission rules thereunder, any person who, after acquiring a registered security, owns more than five percent of that class of securities must send a Schedule 13D to the issuer, the relevant stock exchanges and the Commission. The schedule must be sent within 10 days of the acquisition that brings the holding over the five percent threshold. The statute provides for a post-acquisition filing rather than a pre-acquisition filing. Thereafter, the person must promptly file amendments to that schedule to reflect any material changes in the information previously disclosed. By Commission rule, any acquisition or disposition of one percent or more of a class of registered equity securities is deemed a material change.

Section 13(d) was enacted in 1968 as part of the Williams Act amendments to the Exchange Act. 2/ It was designed to provide information to the public and the affected issuer concerning the rapid accumulation of equity securities by any person who as a result of such accumulation may be in a position to change or influence control. The theory of the statute is that the required public disclosure provides the market with information necessary for accurate price adjustments based on potential control shifts. Further, the required disclosure gives investors the information necessary

---

2/ As enacted in 1968, Section 13(d)(1) related to 10 percent beneficial ownership. Congress reduced that amount to the current five percent in 1970.

to evaluate such price adjustments. To implement the objective of providing relevant information and a fair opportunity to evaluate the market for the affected securities, the Commission adopted Schedule 13D and appropriate rules.

Schedule 13D contains six general areas of information, as well as certain exhibits: (1) the identity of the security being acquired and its issuer; (2) the identity and background of the person filing the statement, including criminal convictions and certain securities laws violations within the past five years; (3) the source and amount of the funds used in the acquisition; (4) the purpose of the transaction; (5) the amount of securities owned; and (6) any arrangements or understandings with respect to the issuer's securities. Two of the more important disclosure items in this form are numbers (4) and (6): the purpose of the transaction; and any arrangements with respect to the securities. In describing the purpose of the transaction, the person must discuss plans or proposals that could result in the acquisition of additional securities or disposition of securities of the issuer, an extraordinary corporate transaction (such as a merger or reorganization), a sale of a material amount of assets, a change in the issuer's management structure, capitalization or business structure, a change in the issuer's governing instruments that would impede the acquisition of control, or a delisting or deregistration of the issuer's securities. In describing arrangements or understandings, the person must discuss any relationship with any other person that would bear on a transfer or voting of the issuer's securities.

The forms are frequently given careful consideration by the Division of Corporation Finance in its review of certain contested takeover bids and by the Division of Enforcement. Moreover, the schedules are public documents and are closely followed by the financial press and the investing public. Finally, Section 13(d) requires delivery of the requisite information to the issuer whose securities are being acquired and to exchanges on which the securities are traded. In 1983 there were over 5,000 filings on Schedule 13D.

Section 13(d) is applicable to the acquisition of an equity security of a class registered under Section 12 of the Exchange Act. The broad definition of equity security in the Exchange Act includes any stock or similar security or any security convertible into such a security. The Commission has limited that definition for purposes of Section 13(d) to exclude from its coverage any non-voting securities.

An important concept under Section 13(d) is that of beneficial ownership. The Commission adopted a definition of the term in 1978 (Rule 13d-3). Under this non-exclusive definition, a beneficial owner includes anyone who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares either voting power or investment power as to a security. Voting power includes the power to vote or to direct the vote of a security. Investment power includes the power to dispose or to direct the disposition of a security. Thus, under Section 13(d), the test for determining coverage of the statute relates to control of the security but not economic benefits from it, such as dividends.

Another important aspect of Section 13(d) is its coverage of an acquisition by any "person." The definition of that term under the securities laws raises interesting questions in the context of two or more persons acting together. The term "person" is defined for purposes of Section 13(d) to include two or more persons who act as a partnership, syndicate or other group for the purpose of acquiring, holding or disposing of securities. The purpose of this is to prevent persons who agree to pool their interests in the issuer's securities from evading the disclosure requirements because individually they own less than five percent of the securities. Cases have held that a group is formed where there is an agreement, formal or informal, to act together for the purpose of acquiring, holding or disposing of securities. The Commission codified this case law by adopting Rule 13d-5(b).

Because Section 13(d) is intended to address rapid accumulations of securities that may affect or influence a change in control, certain acquisitions that are unrelated to such purpose are exempt from the provision's requirements. Notably, Section 13(d) does not apply to acquisitions of no more than two percent of a class within a 12 month period. 3/ Also exempted from the filing requirements of Section 13(d)

3/ The exemption for two percent acquisitions within a 12-month period applies only to the initial filing, not to changes in beneficial ownership once the filing person has passed the five percent threshold.

are acquisitions by certain institutional investors, such as broker-dealers, who acquire in the ordinary course of business without the purpose or effect of changing or influencing control of the issuer. In order to create a comprehensive system of beneficial ownership reporting, however, Congress adopted Section 13(g) in 1977. That section authorizes the Commission to require disclosure by any beneficial owner of more than five percent of a class of registered equity securities even if reporting would not be required under Section 13(d). The Commission adopted Schedule 13G in 1978. That schedule must be filed within 45 days after the end of the fiscal year by persons who beneficially own more than five percent of an issuer's registered equity securities and who are not required to file a Schedule 13D.

The final provision of the Exchange Act that is related to beneficial ownership is Section 13(f). That provision and the Commission's rules thereunder generally require quarterly reporting on Form 13F as to certain securities held by (1) any person exercising investment discretion over accounts of others, or (2) any person, other than a natural person, investing in or buying or selling securities for its own account if the accounts over which such person has investment discretion, or such person's own holdings, have an aggregate fair market value of at least $100 million on the last trading day in any calendar month. Form 13F requirements apply regardless of whether or not the institutional investment manager owns more than five percent of a class of registered equity securities.

2. Tender Offers

Another method by which a person may acquire registered equity securities is through a tender offer. Although the term "tender offer" is not defined in any statute or rule, the courts and the Commission generally regard it to include more than just conventional tender offers in which the persons involved label their buying programs as tender offers. 4/

A bidder can make a tender offer for cash or in exchange for its own securities. Exchange Act provisions govern the tender offer in either case, but if securities are offered publicly as part of the consideration, the Securities Act of 1933 (the "Securities Act") will also apply to the transaction. 5/

a. Cash Tender Offers

Sections 14(d) and 14(e) provide for federal regulation of tender offers. 6/ These provisions were adopted in 1968 and amended in 1970 as part of the Williams Act amendments to the Exchange Act. Through the imposition of certain procedural rules, the requirement to disseminate certain information, and the prohibition of fraudulent, deceptive and manipulative acts

---

4/ Release No. 34-16385 (November 29, 1979).

5/ As under Section 13(d), there is an exemption from the tender offer provisions for a tender offer that when added to other acquisitions within the preceding 12 months will result in the acquisition of less than two percent of the affected class.

6/ While Section 14(d) is applicable only to specified classes of securities, such as those securities registered under Section 12 of the Exchange Act, Section 14(e) applies to any tender offer whether or not the target company's securities are registered pursuant to Section 12.

and practice in connection with tender offers, these provisions represent Congress's intent to provide investor protection by ensuring adequate information and sufficient time to make an investment decision without undue pressure. Congress took extreme care in adopting these provisions to avoid tipping the regulatory balance in favor of either the bidder or the target. These three policy objectives - adequate information, sufficient time, and regulatory neutrality - have been the consistent themes underlying the Commission's application and interpretation of the tender offer provisions.

i) Information Requirements. Section 14(d)(1) of the Exchange Act provides that no tender offer for a registered equity security may be made which would result in the bidder beneficially owning more than five percent of the issuer's securities unless, at the time the offer is first published, sent, or given to security holders, the bidder has filed a required disclosure statement with the Commission. The bidder's statement on Schedule 14D-1 must contain essentially all the same information as Schedule 13D. It also must disclose the exact number of shares being sought, the consideration being offered, the identity of the principal market in which the securities are traded, and any transaction or negotiations during the preceding three years between the bidder and the target. If the bidder is not a natural person and its financial condition is material, the schedule must also include appropriate financial information.

The bidder must deliver a copy of its Schedule 14D-1 to the target company and any other bidders. It also must give telephonic notice to relevant stock exchanges of certain specified terms of the offer, as well as provide those exchanges with the Schedule 14D-1. Finally, the bidder must disseminate a fair and adequate summary of the Schedule 14D-1 information to all security holders of the target company.

Tender offer provisions also require a response by the target company. Within 10 business days following commencement of the tender offer, the target company must file a Schedule 14D-9 that includes a statement which recommends acceptance or rejection of the tender offer, adopts a neutral position or states that management is unable to take a position with respect to the tender offer. The statement must also include the reasons for the recommendation or other position, a description of any transactions by management in the target's securities during a specified period, and an identification of any person retained to make solicitations or recommendations to security holders. The same information must be published or sent to security holders.

ii) Substantive Regulation. In addition to disclosure, federal securities law provides for substantive regulation of tender offers. By Commission rule, a tender offer must remain open for at least 20 business days 7/ from its commencement. 8/ This rule was adopted to assure that shareholders have sufficient time to make their investment decisions, without undue pressure, on the basis of adequate and complete information and to permit the effective functioning of the information dissemination requirements of the tender offer provisions. Other timing provisions interrelate with and are based on the minimum 20 business day offering period. Thus, for example, if a bidder increases the offer price, the offer must remain open for at least 10 business days from the date of the price increase, regardless of when the original 20 day offering period ends. 9/

During the pendency of an offer, shareholders must be afforded a right to withdraw any tendered shares for the first 15 business days of the offer. The bidder must also extend withdrawal rights for 10 business days following commencement of any competing bid. Finally, the bidder

---

7/ A business day is any day other than a Saturday, Sunday or federal holiday.

8/ Generally, a tender offer is deemed to commence on the date it is first published, sent or given to security holders.

9/ For example, if the price increase is announced on business day 15 following commencement of the tender offer, the offer would be required to remain open until business day 25.

must give tendering shareholders the right to withdraw any unpurchased deposited shares beginning 60 days after commencement of the offer. 10/

Under the tender offer provisions of the Exchange Act, if a bidder is seeking less than all the shares of an issuer's registered equity securities and if a number greater than the tender offer are tendered, the bidder must purchase shares on a pro rata basis. That is, the bidder must buy from all tendering shareholders that percentage of their tendered shares which is equal to the relationship of the overall number of shares sought to the total number of shares tendered.

Finally, the Williams Act requires that if the consideration is increased during the tender offer, the bidder must pay the increased consideration to each security holder whose securities are purchased pursuant to the tender offer.

iii) Commission Review. Tender offer disclosure materials filed with the Commission are subject to review and comment by the staff. This will generally mean that the staff will contact the bidder within three business days after receipt of a Schedule 14D-1 with comments on the filing. The bidder will discuss with the staff the steps it intends to take to

---

10/ This prevents a bidder from locking up shares for an undue period without paying for them. Because most tender offers do not remain open for 60 days, this withdrawal rule is usually not significant. Where an offer must receive approval from another regulatory authority prior to its consummation, however, the provision may be more important, particularly if the offer is deemed commenced upon filing with that regulatory authority and if that authority's review could be lengthy.

comply with these comments. Where the bidder's corrective response is inadequate, the staff will consider referral to our Division of Enforcement. Based on the language and the legislative history of the Williams Act, the Commission has traditionally taken the position that the primary objective of the tender offer provisions is to provide investor protection in a takeover situation rather than to regulate the tender offer as an economic phenomenon. 11/ The staff is neutral in takeover contests and administers the statute in an even-handed manner which neither obstructs nor facilitates the tender offer except to the extent necessary to ensure investor protection. Our records indicate that during fiscal year 1983, 12 companies in the petroleum industry were the targets of cash tender offers. 12/

b. Exchange Offer

Where the acquisition of registered equity securities is made by a tender offer involving an exchange of the bidder's securities for those of

---

11/ See Testimony of former SEC Commissioner Philip A. Loomis on Regulation Under Federal Banking and Securities Laws of Persons Involved in Corporate Takeovers, before the Senate Committee on Banking, Housing and Urban Affairs, February 16, 1976.

12/ These included Damson Oil Corp's bid for Juniper Petroleum Corp.; Mesa Petroleum Co's bid for General American Oil Company of Texas; R-H Holdings Corporation's bid for The El Paso Company; Atlantic Acquisition Corp.'s bid for Atlantic Oil Corp.; Yankee Oil & Gas Inc.'s bid for Resource Exploration, Inc.; Coastal Corp's bid for Texas Gas Resources; CSX Corporation's bid for Texas Gas Resources; InterNorth, Inc.'s bid for Belco Petroleum Corporation; SEDCO, Inc.'s bid for Pogo Producing Company; Diamond Shamrock Corporation's bid for Watomas Company; Cotton Petroleum Corporation's bid for Cotton Petroleum Corporation 1976 Oil and Gas Program; and The Williams Companies' bid for Northwest Energy Company.

the target, both the Exchange Act and the Securities Act will be applicable. The Exchange Act will apply to the same extent as with a cash tender offer. The Securities Act will govern the transaction to the extent that it involves the offer and sale of the bidder's securities.

Essentially a disclosure statute concerned with distributions of securities, the Securities Act has two objectives: the provision of full and fair disclosure in connection with the sale of securities in interstate commerce; and the prevention of fraud in the offer and sale of such securities. Section 5 of the Securities Act requires registration with the Commission of any offer or sale of a security, unless the transaction comes within one of the statutory exemptions. That section also requires the prospectus that is part of the registration statement to meet certain disclosure standards and to be delivered to investors. The Commission has broad authority to prescribe the overall content of a registration statement and has adopted a comprehensive disclosure system that it administers to further the policies of the Securities Act.

The Securities Act specifies that no sales may be made until the registration statement is effective. Section 8 of the Securities Act provides that a registration statement will become effective 20 days after filing, or after an amendment filed prior to the effective date, unless the Commission accelerates that waiting period. 13/ As a practical matter,

---

13/ Section 8 of the Securities Act requires the Commission to base any decision to accelerate effectiveness on the adequacy of the information respecting the issuer already available to the public, on the facility with which the nature of the securities can be understood, and on the public interest and the protection of investors.

however, registrants typically include a provision in the registration statement that delays its effectiveness indefinitely until the staff comment process is completed. The same procedure would apply to exchange offers. The date of commencement of an exchange offer is the date the registration statement is declared effective.

The registration statement required under the Securities Act must include disclosure regarding the issuer of the securities, the securities themselves and the terms of the transaction. The registrant must also furnish information about the company whose securities are being acquired to the extent such information can be obtained. This disclosure is disseminated to security holders along with any other information required by Exchange Act tender offer provisions.

In reviewing and commenting on a registration statement under the Securities Act, the Commission staff does not pass on the merits of the transaction. Rather, its purpose is to evaluate the disclosure from the standpoint of whether full and fair disclosure is being made to security holders to enable them to make an informed investment decision.

B. Mergers

Although a merger transaction may follow an acquisition of shares, either by open market or privately negotiated purchase or by tender offer, 14/ it may also be the sole method by which a company is acquired. In that case,

---

14/ See, Freund and Easton, The Three-Piece Suitor: An Alternate Approach to Negotiated Corporate Acquisitions, 34 Bus. Law. 1679 (1979).

the transaction is typically negotiated between the two parties and submitted to a vote of security holders. The consideration offered to security holders may take the form of cash or securities of the acquiring entity. The federal securities laws would apply in two respects: (1) the solicitation of the vote of security holders by the entity to be acquired will be governed by the proxy provisions of the Exchange Act; and (2), if securities will be issued by the acquiring entity, such issuance will be covered by the Securities Act. 15/ Although these statutes have separate requirements with respect to the transaction, the underlying policy objectives are the same - the provision of adequate disclosure to security holders so that they can make an informed evaluation of the merger proposal. Thus, where the merger is subject to the two statutes, the Commission permits the parties to the transaction to discharge their obligations under both statutes through the use of a combined registration/proxy statement. Because the solicitation of security holders is covered under the Securities Act as an offer of

---

15/ If the merger transaction were with an affiliated party and would result in the number of shareholders dropping below 300, it would be covered by Section 13(e) of the Exchange Act and Commission rules thereunder. These provisions govern so-called "going private" transactions and require the party engaged in the transaction to file a Schedule 13E-3 with the Commission and disseminate a summary of the filed information to security holders. Along with information about the transaction, its purpose, and alternatives considered, the party engaged in the transaction must state whether the transaction is "fair or unfair" to unaffiliated holders.

securities and under the Exchange Act as a proxy solicitation on the plan of merger, the registration/proxy statement will generally not be disseminated until the staff has had an opportunity to review the filing and declare the registration statement effective.

The information in a registration/proxy statement generally includes the principal terms of the plan of merger, substantive descriptions of the business and financial condition of both parties to the transaction and pro forma financial information. There additionally will be a detailed discussion concerning the principal security holders of both companies, the management of both companies and a description of any interest of such persons in the proposed transaction beyond that of any other security holder. Generally, as with most Commission filings, the material, along with subsequent amendments, will be available to any member of the public.

C. Processing of Filings Under the Securities Act and the Exchange Act

In discussing applicable provisions of the Securities Act and the Exchange Act, mention has been made of staff review of various filings. It may be useful to summarize the essential principles involved in this function. The Commission's Rules of Practice and Investigation provide for the processing of filings made with the Commission. If a filing appears to provide inadequate disclosure of material information, the usual practice is to bring the matter to the attention of the issuer 16/

16/ If time permits, the staff will raise comments in writing. Otherwise, the comment process will take place by telephone.

and to provide a reasonable opportunity for discussion of the matter and where appropriate to permit the filing of a corrective amendment. This procedure would not be followed when the matter appears to stem from a willful disregard of the applicable disclosure requirements or a willful attempt to conceal or mislead. In those instances, enforcement proceedings generally would be instituted.

The Commission is not in a position to independently investigate all material statements made in documents filed with it. Generally, staff review is limited to a substantive analysis of the disclosures made and an evaluation of whether, based on such analysis, the information contained in the document appears complete and does not appear to omit information required by applicable rules or other material information. Further, an evaluation is made as to whether, based upon the staff's analysis, the statements made in the document appear consistent with other disclosures made by the company, with public information otherwise available regarding the company's customers and suppliers and with other information publicly available regarding the industry, its problems and its outlook.

In order to discharge its review responsibilities, the Commission retains a staff of accountants, financial analysts and attorneys. Documents filed with the Commission are reviewed by these staff members in an effort to determine whether there appear to be any questions regarding compliance with the statutory requirements. These statutes, however, generally do not authorize the Commission to exercise any regulatory controls over the internal affairs of the companies subject to these disclosure requirements. Rather, such regulations were designed to provide sufficient material information upon which investors may make informed decisions. Thus, the Commission is not authorized to and does not pass upon the advisability of a proposed merger, the adequacy of the terms of an offer or the ultimate effect of a transaction on the company, its owner, customers or suppliers.

III. Advisory Committee on Tender Offers

As is evident from this explanation of federal securities law provisions that would be relevant in the case of the substantial acquisition of stock in or merger with another company, the current regulatory framework is comprehensive and highly developed. Changes in this framework must be undertaken carefully and with full understnading of how the overall regulatory structure would be affected. With this in mind, the Commission sought the advice of experts last year when it established its Advisory Committee on Tender Offers.

A. Origins and Objectives of the Tender Offer Advisory Committee

The Commission established the Advisory Committee on Tender Offers on February 25, 1983, to study the fundamental changes that acquisition practices have undergone since the Williams Act was adopted in 1968. In view of substantial changes in the size, nature and complexity of such transactions, the Commission concluded that it was appropriate to undertake a major reexamination of the tender offer process and to obtain recommendations for appropriate legislative and regulatory changes.

The Advisory Committee was requested to review tender offer practices and regulations and propose specific regulatory and legislative improvements for the benefit of all shareholders (i.e. shareholders of all corporations, whether potential acquirors, target companies or bystanders).

The eighteen distinguished members of the Advisory Committee included fourteen members of the business and financial community and the legal and accounting professions, who have been actively involved in numerous tender offers as institutional investors, bidders, targets, arbitrageurs, investment and commercial bankers, attorneys and accountants. Also serving as members were two academicians who have written extensively on the subject, a former Supreme Court Justice and a former state securities commissioner. 17/

B. Overview of Advisory Committee Meetings and Conclusions

All meetings of the Advisory Committee were open to the public. At its first meeting on March 18, 1983, the Advisory Committee reached agreement on the appropriate scope of its review, stating that it not only would consider the whole spectrum of acquisition techniques but also would focus on those issues which are common to acquisitions of control through purchases of equity securities from investors. 18/ At that meeting, the Advisory Committee formed six working subcommittees, which were to hold numerous informal meetings between sessions of the full Committee.

17/ See Exhibit A for the members of the Advisory Committee.

18/ See Section I of the Advisory Committee's Agenda of Issues, which is attached as Exhibit B.

The Advisory Committee held its second and third meetings on April 15 and May 13 in New York City. At these meetings each of the working groups reported on their activities and on their meetings with representatives of various government agencies, including Chairman Miller of the Federal Trade Commission, Chairman Volcker of the Federal Reserve Board and a representative of the Department of the Treasury. The Committee also discussed the tender offer experience and regulatory response in Great Britain with the Director-General of the London Panel on Take-Overs and Mergers. On June 2 the Advisory Committee held a full day meeting in New York City for the purpose of receiving presentations from commentators and other interested parties, including former Assistant Attorney General William Baxter.

At the Advisory Committee meeting in Washington D.C. on June 10, 1983, the Committee considered and reached agreement on the recommendations to be included in its final report. Committee members presented the report and discussed the recommendations with the Commission and senior staff on July 8, 1983. The Commission promptly delivered copies of the report to the members of the House Subcommittee on Telecommunications, Consumer Protection and Finance and the Senate Banking Committee.

The recommendations of the Advisory Committee were organized into the following categories: Economics of Takeovers and their Regulation, Objectives of Federal Regulation of Takeovers, Regulation of Acquirors of Corporate Control, Regulation of Opposition to Acquisition of Control, Regulation of Market Participants, and Interrelationship of Various

Regulatory Schemes. In presenting the report, Advisory Committee Chairman Dean LeBaron emphasized (i) the Advisory Committee's reliance on competitive markets as the ultimate regulator; (ii) the Advisory Committee's desire to promote private investment systems and not hamper capital formation by heavy reliance on rulemaking; (iii) the Committee's goal of disclosure of meaningful information to all investors; and (iv) the Committee's preference for solutions which are characterized by flexibility, simplicity and lower costs. 19/ The Commission endorses those principles.

C. Commission Response to Advisory Committee Recommendations

The Commission commends the Advisory Committee for its outstanding efforts. Although faced with a demanding schedule, the Advisory Committee performed a comprehensive review of the acquisition process and presented the Commission with fifty thoughtful and comprehensive recommendations, including recommendations for legislative and regulatory changes.

The Commission staff has been engaged in a detailed analysis of the Committee's recommendations since they were received. The Commission considered the staff's analysis of the Committee's recommendations at an open meeting on March 13, 1984.

19/ See attached July 8, 1983 letter from Dean LeBaron, Chairman, Advisory Committee on Tender Offers, to Securities and Exchange Commission Chairman John S.R. Shad, transmitting the Report of Recommendations of the Advisory Committee on Tender Offers (Exhibit C).

Of the recommendations, the Commission agreed with thirty-four, 20/ qualified thirteen, 21/ disagreed with six 22/ and concluded that three require further study. 23/ Because some of the recommendations have subparts, these numbers total more than fifty.

Of the recommendations endorsed, the Commission concluded that six 24/ require federal legislation and fourteen 25/ can be implemented under the Commission's existing rulemaking authority. No formal action is required on the remaining recommendations endorsed by the Commission.

The Commission's specific positions on each Committee recommendation are as follows:

20/ Recommendations 1, 3, 5, 6, 7, 8, 9(a), 9(c), 9(d), 9(e), 10, 11, 20, 21, 22, 23, 24, 25, 26, 28, 29, 30, 31, 32, 34, 37(b), 39(b), 43, 44, 45, 46, 48, 49, 50.

21/ Recommendations 2, 4, 9(b), 12, 13, 17, 18, 33, 35, 36, 38, 41, 42.

22/ Recommendations 15, 19, 27, 37(a), 39(a), 40.

23/ Recommendations 14, 16, 47.

24/ Recommendations 13, 21, 38, 39(a), 41, 43.

25/ Recommendations 5, 11, 12, 17, 18, 20, 22, 29, 37(b), 39(b), 44, 45, 46, 48.

COMMITTEE RECOMMENDATIONS AND THE COMMISSION'S POSITIONS AND CONTEMPLATED ACTIONS

I. Economics of Takeovers and their Regulation

1. The purpose of the regulatory scheme should be neither to promote nor to deter takeovers; such transactions and related activities are a valid method of capital allocation, so long as they are conducted in accordance with the laws deemed necessary to protect the interests of shareholders and the integrity and efficiency of the capital markets.

The Commission agrees with this general proposition. It requires no specific action.

2. There is no material distortion in the credit markets resulting from control acquisition transactions, and no regulatory initiative should be undertaken to limit the availability of credit in such transactions, or to allocate credit among such transactions.

The Commission has limited expertise in this area, but agrees with this general proposition. It requires no specific action.

II. Objectives of Federal Regulation of Takeovers

3. Takeover regulation should not favor either the acquiror or the target company, but should aim to achieve a reasonable balance while at the same time protecting the interests of shareholders and the integrity and efficiency of the markets.

The Commission agrees with this general proposition. It requires no specific action.

4. Regulation of takeovers should recognize that such transactions take place in a national securities market.

The Commission agrees with this general proposition, which is consistent with Edgar v. MITE Corp., 26/ and the Commission's amicus briefs in MITE and Sharon Steel v. Whaland. 27/ However, the Commission's agreement should not be construed to justify a wholesale preemption of state corporate law. No specific action is required on this recommendation.

5. Cash and securities tender offers should be placed on an equal regulatory footing so that bidders, the market and shareholders, and not regulation, decide between the two.

The Commission supports the general proposition that regulatory disincentives to exchange offers should be minimized to the extent consistent with investor protection. Implementation of this recommendation and Recommendations 11 and 12 will be the final major steps in the integration of the Securities Act and the Exchange Act disclosure requirements. It will require an amendment to rules and administrative policies under the Securities Act.

6. Regulation of takeovers should not unduly restrict innovations in takeover techniques. These techniques should be able to evolve in relationship to changes in the market and the economy.

The Commission agrees with this general proposition. It requires no specific action.

26/ 457 U.S. 624 (1982).

27/ [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,528 (N.H., Sept. 30, 1983).

7. Even though regulation may restrict innovations in takeover techniques, it is desirable to have sufficient regulation to insure the integrity of the markets and to protect shareholders and market participants against fraud, nondisclosure of material information and the creation of situations in which a significant number of reasonably diligent small shareholders may be at a disadvantage to market professionals.

The Commission agrees with this general proposition. It requires no specific action.

8. The evolution of the market and innovation in takeover techniques may from time to time produce abuses. The regulatory framework should be flexible enough to allow the Commission to deal with such abuses as soon as they appear.

The Commission agrees with this general proposition. It requires no specific action.

9. a. State Takeover Law. State regulation of takeovers should be confined to local companies.

The Commission agrees with this general proposition, which is consistent with MITE and the Commission's amicus program. It requires no specific action.

b. State Corporation Law. Except to the extent necessary to eliminate abuses or interference with the intended functioning of federal takeover regulation, federal takeover regulation should not preempt or override state corporation law. Essentially the business judgment rule should continue to govern most such activity.

The Commission agrees with the Advisory Committee's recognition of the general preeminence of state corporate law with respect to the internal affairs of a corporation. However, in the application of the business judgment rule in a change of control context, the Commission believes that shareholders would be better served if the courts gave greater recognition to potential conflicts of interest between management and shareholders. No specific action is required on this recommendation.

> c. State Regulation of Public Interest Businesses. Federal takeover regulation should not preempt substantive state regulation of banks, utilities, insurance companies and similar businesses, where the change of control provisions of such state regulation are justified in relation to the overall objectives of the industry being regulated, do not conflict with procedural provisions of federal takeover regulation and relate to a significant portion of the issuer's business.

The Commission agrees with this general proposition. It requires no specific action.

> d. Federal Regulation. Federal takeover regulation should not override the regulation of particular industries such as banks, broadcast licensees, railroads, ship operators, nuclear licensees, etc.

The Commission agrees with this general proposition. It requires no specific action.

> e. Relationships with Other Federal Laws. Federal takeover regulation should not be used to achieve antitrust, labor, tax, use of credit and similar objectives. Those objectives should be achieved by separate legislation or regulation.

The Commission agrees with this general proposition. It requires no specific action.

III. Regulation of Acquirors of Corporate Control

10. Any regulation of one or more change of control transactions by either the Congress or the Commission should address the effects of such regulation in the context of all control acquisition techniques.

The Commission agrees with this general proposition. It requires no specific action.

11. The concept of integration of disclosure under the Securities Act of 1933 and the Securities Exchange Act of 1934, previously effected by the Commission in securities offerings for cash, should be extended to exchange offers.

The Commission agrees with this recommendation. It will require an amendment to rules and administrative policies under the Securities Act and the Exchange Act.

12. Bidders should be permitted to commence their bids upon filing of a registration statement and receive tenders prior to the effective date of the registration statement. Prior to effectiveness, all tendered shares would be withdrawable. Effectiveness of the registration statement would be a condition to the exchange offer. If the final prospectus were materially different from the preliminary prospectus, the bidder would be required to maintain, by extension, a 10-day period between mailing of the amended prospectus and expiration, withdrawal and proration dates. This period would assure adequate dissemination of information to shareholders and the opportunity to react prior to incurring any irrevocable duties.

The Commission agrees with this recommendation generally, reserving judgment on specific means of effecting the proposal. It will require an amendment to rules and administrative policies under the Securities Act.

13. No person may acquire directly or indirectly beneficial ownership of more than 5% of an outstanding class of equity securities unless such person has filed a Schedule 13D and that schedule has been on file with the Commission for at least 48 hours. Such person may rely on the latest Exchange Act report filed by the target company that reports the number of shares outstanding. The acquiror would have to report subsequent purchases promptly as provided by current law.

The Commission endorses closing the 10-day window period in Section 13(d). The Commission opposes a pre-acquisition filing requirement, because of its effect on the transferability of blocks of stock. The Commission proposes instead a requirement of immediate public announcement, next day filing of the Schedule 13D and/or a standstill until filing. The Commission's proposal will require an amendment to the Exchange Act.

14. No person may acquire voting securities of an issuer, if, immediately following such acquisition, such person would own more than 20% of the voting power of the outstanding voting securities of that issuer unless such purchase were made (i) from the issuer, or (ii) pursuant to a tender offer. The Commission should retain broad exemptive power with respect to this provision.

The Commission has serious reservations about this recommendation. Further study of the economic implications for the entire change of control area is required.

15. The Committee encourages the Commission to study means to strengthen the concept and definition of "group" or concerted activity.

The Commission has reviewed its rules and interpretations in light of this recommendation and concluded that additional action is not necessary at this time. The Commission will continue to monitor this area.

16. The minimum offering period for a tender offer for less than all the outstanding shares of a class of voting securities should be approximately two weeks longer than that prescribed for other tender offers.

The Commission is sensitive to the Committee's concerns regarding two-tier and partial offers but is not certain that the Committee's recommendation is the best way to address these concerns. This issue requires further study.

17. The minimum offering period for an initial bid should be 30 calendar days; for subsequent bids the minimum offering period should be 20 calendar days, provided that the subsequent bid shall not terminate before the 30th calendar day of the initial bid. In each case, the minimum offering period will be subject to increase, if the bid is a partial offer. The period during which tendering shareholders will have proration and withdrawal rights should be the same length as the minimum offering period.

The Commission believes the tender offer process should not be permitted to become so complex that it is understood only by investment professionals. See Recommendation 32. The Committee's recommendations with respect to the timing of tender offers are too complex and may disadvantage non-professional shareholders. Shareholders would be better served by a system that simply provides for prorationing and withdrawal throughout the offering period, and a required minimum 20-business day offering period. The Commission endorses the Committee's proposal to eliminate the automatic extension of withdrawal rights upon commencement of a competing bid. The Commission intends to propose appropriate rule changes.

18. The minimum offering period and prorationing period should not terminate for five calendar days from the announcement of an increase in price or number of shares sought.

The Commission agrees that the offering period should be extended if there is an increase in price or the number of shares sought. Since prorationing and withdrawal rights are proposed to be required throughout an offer, any extension of the offer will automatically extend such rights. The Commission reserves judgment on the length of the extension, pending public comment on a proposed rule change.

19. Where the bidder discloses projections or asset valuations to target company shareholders, it must include disclosure of the principal supporting assumptions provided to the bidder by the target.

The Commission does not endorse this recommendation at this time. In 1982, the Commission determined not to adopt a requirement of disclosure of assumptions when it issued its policy statement on projections 28/ and in 1979 when it adopted Rules 175 under the Securities Act and 3b-6 under the Exchange Act, 29/ which provide a safe harbor for such disclosures.

20. The Commission should review its disclosure rules and the current disclosure practices of tender offer participants to eliminate unnecessary or duplicative requirements, as well as inordinately complex or confusing disclosures. The Commission's rules should require a clear and concise statement of the price, terms and key conditions of the offer. In addition, the Commission should amend its rules to permit inclusion of the key conditions in a summary advertisement used to commence an offer.

28/ See Release No. 33-6383 (March 3, 1982).

29/ See Release No. 33-6084 (June 25, 1979).

The Commission agrees with this recommendation, and intends to propose appropriate rule changes.

21. The Commission should continue its efforts to facilitate direct communications with shareholders whose shares are held in street name.

The Commission agrees with this recommendation. In order to facilitate communications with beneficial shareholders, the Commission has implemented a broker-dealer program and recommended legislation to implement a program for banks and other nominees.

22. The Commission should require under its proxy and tender offer rules that a target company make available to an acquiror, at the acquiror's expense, shareholder lists and clearinghouse security position listings within five calendar days of a bona fide request by an acquiror who has announced a proxy contest or tender offer. The Commission should consider prescribing standard forms (written or electronic) for the delivery of such information.

The Commission agrees with this recommendation, and intends to propose appropriate rule changes.

23. Tender offer reply forms should be standardized to the extent possible to facilitate handling by brokerage firms, banks and depositaries.

The Commission agrees with this recommendation, and will assist private sector initiatives in this area.

24. Except to the extent there already exists such a requirement in a particular context, the price paid by an acquiror unaffiliated with the target company should not be required to be "fair" nor should federal law provide for state law-type appraisal rights.

The Commission agrees with this endorsement of current law. No action is required.

25. All shareholders whose shares are purchased in a tender offer should be entitled to the highest per share price paid in the offer.

The Commission agrees with this endorsement of current federal securities regulation. No action is required.

26. Current prohibitions of the purchase by a bidder of target company shares other than under the offer should be continued.

The Commission agrees with this endorsement of current federal securities regulation. No action is required.

27. All time periods should be defined in terms of calendar days.

The Commission believes that all time periods should continue to be defined in terms of business days. No action is required.

28. "Commencement" of a tender offer should continue to be determined by present rules, and time periods should continue to run from that date.

The Commission agrees with this endorsement of current federal securities regulation. No action is required.

29. Offering documents that are required to be mailed should be mailed within seven calendar days of commencement by announcement.

The Commission agrees with this recommendation, and intends to propose appropriate rule changes.

30. Voluntary extensions may be made by the offeror with any type of offer at any time before the commencement of the first trading day after the expiration date of the offer.

The Commission agrees with this endorsement of current federal securities regulation. No action is required.

31. Approval by shareholders of a bidder with respect to an acquisition should continue to be an internal matter between shareholders and management, subject only to applicable state law.

The Commission agrees with this endorsement of current law. No action is required.

32. The takeover process should not be permitted to become so complex that it is understood only by investment professionals.

The Commission agrees with this general proposition. No action is required.

IV. Regulation of Opposition to Acquisitions of Control

33. The Committee supports a system of state corporation laws and the business judgment rule. No reform should undermine that system. Broadly speaking, the Committee believes that the business judgment rule should be the principal governor of decisions made by corporate management including decisions that may alter the likelihood of a takeover.

The Commission agrees with this general proposition, qualified by its concerns regarding the application of the business judgment rule in change of control situations. See Recommendation 9(b).

34. State laws and regulations, regardless of their form, that restrict the ability of a company to make a tender offer should not be permitted because they constitute an undue burden on interstate commerce. Included in this category should be statutes that prohibit completion of a tender offer without target company shareholder approval and broad policy legislation written so as to impair the ability to transfer corporate control in a manner and time frame consistent with the federal tender offer process. An exception to this basic prohibition may be appropriate where a significant portion of the target company is in a regulated industry and where special change of control provisions are vital to the achievement of ends for which the industry is regulated. Where such change of control provisions cannot be justified in relation to the overall objectives of the industry regulations or where only a small portion of the target company is in the regulated industry, there should not be an automatic impediment to the completion of a tender offer. Rather, the tender offer should be completed with the regulated business placed in trust during any post-acquisition approval period. Further, no such regulation should interfere with the procedural provisions under the Williams Act.

The Commission agrees with this general proposition, and intends to continue to implement this policy through its amicus program, which has been effective to date.

35. Congress and the Commission should adopt appropriate legislation and/or regulations to prohibit the use of charter and by-law provisions that erect high barriers to change of control and thus operate against the interests of shareholders and the national marketplace.

The Commission shares the serious concerns of the Advisory Committee with respect to the effects of these devices but is not prepared at this time to concur in such a broad intrusion into state corporate law.

36. To the extent not prohibited or otherwise restricted, companies should be permitted to adopt provisions requiring supermajority approval for change of control transactions only where the ability to achieve such a level of support is demonstrable.

a. Any company seeking approval of a charter or by-law provision that requires, or could under certain circumstances require, the affirmative vote of more than the minimum specified by state law should be required to obtain that same level of approval in passing the provision initially. Ratification should be required every three years.

b. Where a charter or by-law provision provides a formula for the required level of approval, which level cannot be determined until the circumstances of the merger are known, the formula shall be limited by law so as to require a vote no higher than the percentage of votes actually ratifying the charter or by-law provision. Ratification should be required every three years.

c. For a nationally traded company that has adopted a supermajority provision prior to the date of enactment of this recommendation, and for a local company with a supermajority provision which becomes nationally traded at a later date, shareholders must ratify the supermajority provision within three years after such date, and continue to ratify such provision every three years thereafter.

The Commission agrees with the Advisory Committee that implementation of super majority voting requirements should require comparable votes for adoption. As noted with respect to Recommendation 35, however, the Commission is not prepared at this time to concur in such a broad intrusion into state corporate law. The Commission does not agree that such provisions should be subject to re-ratification after adoption. Therefore, the Commission does not plan to take actions to implement 36(a), 36(b), or 36(c).

37. The Commission should designate certain change of control related policies of corporations as "advisory vote matters" for review at each annual stockholders' meeting for the election of directors and for disclosure in the proxy statement.

a. Matters Covered. Advisory vote matters should include:

   i. Supermajority provisions. To the extent not prohibited or otherwise restricted, charter provisions requiring more than the statutorily imposed minimum vote requirement to accomplish a merger, including provisions requiring supermajority approval under special conditions (e.g., "fair value" and "majority of the disinterested shareholders" provisions);

   ii. Disenfranchisement. Charter provisions (other than cumulative voting and class voting) that abandon the one-share, one-vote rule based on the concentration of ownership within a class (e.g., formulas diluting voting strength of 10% shareholders, and "majority of the disinterested shareholders" approval requirements);

   iii. Standstill agreements. Current agreements with remaining lives longer than one year that restrict or prohibit purchases or sales of the company's stock by a party to the agreement; and

   iv. Change of control compensation. Arrangements that provide change of control related compensation to company managers or employees.

b. Proxy Statement Disclosure. Companies should be required to disclose all advisory vote matters in a "Change of Control" section of the proxy statement.

c. Vote. Shareholders should be requested to vote on an advisory basis as to whether they are or continue to be in favor of the company's policy with respect to the advisory vote matters disclosed in the proxy statement. The board would not be bound by the results of the advisory vote but could, in its own judgment, decide whether company policy should be changed on the advisory vote matters. The outcome of an advisory vote would have no legal effect on an existing agreement.

The Commission supports 37(b) and will propose for comment the concept of annual disclosure of certain change of control related policies. The Commission believes that the concept of advisory voting is problematic, however, and does not at this time support that element of the recommendation. Advisory votes have, by definition, no binding effect on directors. Such votes would subject corporations to considerable time and expense. The legal effect of advisory votes is unclear and could only be determined through costly litigation. Moreover, such a requirement could interfere fundamentally with traditional principles of corporate governance and fiduciary obligations of management applicable under state law. Because of the costs of advisory votes and the uncertain benefits, the Commission, while commending the Advisory Committee's originality in formulating the concept, does not endorse it.

38. a. Change of Control Compensation During a Tender Offer.

The board of directors shall not adopt contracts or other arrangements with change of control compensation once a tender offer for the company has commenced.

b. Change of Control Compensation Prior to a Tender Offer.

i. Disclosure. The issuer should disclose the terms and parties to contracts or other arrangements that provide for change of control compensation in the Change of Control section of the annual proxy statement.

ii. Advisory Vote. At each annual meeting, shareholders should be requested to vote, on an advisory basis, as to whether the company should continue to provide change of control compensation to its management and employees. The board would not be obligated by the results of the vote to take any specific steps, and the outcome of the vote would have no legal effect on any existing employment agreement.

The Commission shares the Committee's concerns with the adoption of change of control compensation in the face of a takeover and concurs in the Committee's judgment that such activities may so undermine the public's confidence in the integrity of the takeover process as to require a federal response. The Commission takes no position on whether this is best done through tax legislation or other federal regulation, but would be happy to assist in the preparation of such legislation. The Commission would suggest distinguishing between arrangements entered into after a takeover is threatened and those adopted in the ordinary course of business. This avoids the substantial problems of separating "golden parachutes" from ordinary employment contracts. As noted with Recommendation 37, the Commission does not favor advisory votes at this time. The Commission does agree that, as is currently required, issuers should disclose change of control related compensation, regardless of the timing of its adoption.

39. a. In general, target company self-tenders should not be prohibited during the course of a tender offer by another bidder for the target company.

The Commission believes defensive issuer tender offers should be prohibited, and intends to propose appropriate legislation.

b. Once a third party tender offer has commenced, the target company should not be permitted to initiate a self-tender with a proration date earlier than that of any tender offer commenced prior to the self-tender.

The Commission agrees with this recommendation, and intends to implement it by appropriate rule changes, pending legislation on 39(a).

40. There should be no general prohibition of the counter tender offer as a defense. The employment of the counter tender offer should be prohibited, however, where a bidder has made a cash tender offer for 100% of a target company.

The Commission has serious concerns about the use of counter tender offers as defensive tactics. Management should bear the burden of proving that a counter tender offer is not motivated by management's self-interest and reflects a reasonable business judgment. No specific action is planned by the Commission.

41. Contracts for the sale of stock or assets to preferred acquirors should continue to be tested against the business judgment rule. During a tender offer, however, the issuance of stock representing more than 15% of the fully diluted shares that would be outstanding after issuance should be subject to shareholder approval.

The Commission supports the concept of requiring shareholder approval for the issuance of any securities representing more than 5% (not 15% as proposed by the Committee) of the class to be outstanding after issuance during a tender offer or proxy contest. Included within this concept would be options, warrants, convertible and other securities. The Commission supports the general proposition that state corporate law, subject to revised application of the business judgment rule in takeovers, should govern disposition of assets during a tender offer. The Commission intends to propose appropriate legislation.

42. The sale of significant assets, even when undertaken during the course of a tender offer, should continue to be tested against the business judgment rule.

The Commission supports this general proposition, subject to revised application of the business judgment rule.

43. Repurchase of a company's shares at a premium to market from a particular holder or group that has held such shares for less than two years should require shareholder approval. This rule would not apply to offers made to all holders of a class of securities.

The Commission agrees with this recommendation, and intends to propose appropriate legislation.

V. Regulation of Market Participants

44. The Commission should continue the current prohibition on short tendering set forth in Rule 10b-4. To ensure the effectiveness of that provision, the Commission also specifically should prohibit hedged tendering.

The Commission agrees with this recommendation. On March 29, 1984, the Commission adopted a rule proposal to that effect. 30/

45. In furtherance of the policy goals of Rule 10b-4, the Commission generally should require in a partial offer that all shares tendered pursuant to a guarantee be physically delivered, rather than permitting delivery only of the certificates for those shares to be actually purchased by the bidder.

The Commission agrees with this recommendation, and intends to propose appropriate rule changes.

46. Rule 10b-4 should be amended to include a specific prohibition of multiple tendering.

The Commission agrees with this recommendation, and, on March 29, 1984, adopted proposed amendments to Rule 10b-4 prohibiting multiple tendering (*see* Exhibit D).

30/ *See* Release No. 34-20799 (March 29, 1984) attached as Exhibit D.

47. The Commission should revise its interpretation of Rule 10b-4 so that for the purposes of determining whether a person has a "net long position" in a security subject to the tender offer, call options on such security which a person has sold and which a person should know are highly likely to be exercised prior to expiration of the offer shall be deemed to constitute sales of the security underlying such options and therefore netted against such person's position in that security.

The Commission believes that the proposed interpretation is too subjective, thus making it difficult to administer and enforce. Therefore, the Commission does not endorse this recommendation, but intends to study the problem further.

48. Without commenting on the technical aspects of the proposal, the Committee recommends adoption of the Commission's proposed Rule 17Ad-14 under the Exchange Act.

The Commission has adopted Rule 17Ad-14, which requires bidders' tender agents to establish during tender offers an account with registered securities depositories to permit financial institutions participating in such depository systems to use the services of the depository to tender shares if desired.

VI. Interrelationship of Various Regulatory Schemes

49. Federal securities regulation of acquisition of corporate control should not impede or otherwise handicap the necessary and appropriate workings of federal antitrust regulations designed to review transactions for antitrust implications prior to their consummation.

The Commission agrees with this general proposition. No specific action by the Commission is required.

50. Premerger notification waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act should be modified so as to take account of the required minimum offering period prescribed under the Williams Act and to avoid, to the extent practicable, delay in completion of a tender offer due to antitrust review.

The Commission agrees with this recommendation and intends to consult with the Federal Trade Commission (which administers Hart-Scott-Rodino), with a view to implementing this recommendation.

D. Conclusion

As discussed above, the Commission intends to submit legislative proposals to implement its responses to five of the Advisory Committee's recommendations 31/ and to take rulemaking actions to implement fourteen. 32/ The Commission would also be pleased to assist Congress in the preparation of legislation concerning golden parachutes.

31/ Recommendations 13, 21, 39(a), 41, 43.

32/ Recommendations 5, 11, 12, 17, 18, 20, 22, 29, 37(b), 39(b), 44, 45, 46, 48.

EXHIBIT A

MEMBERS OF THE SECURITIES AND EXCHANGE COMMISSION ADVISORY COMMITTEE ON TENDER OFFERS

Dean LeBaron, Chairman
President
Batterymarch Financial Management

Jeffrey B. Bartell, Esq.
Quarles & Brady
(former state securities commissioner)

Michael D. Dingman
President
The Signal Companies, Inc.

Frank H. Easterbrook
Professor of Law
The University of Chicago Law School

Joseph H. Flom, Esq.
Skadden, Arps, Slate, Meagher & Flom

Honorable Arthur J. Goldberg
(former Supreme Court Justice)

Robert F. Greenhill
Managing Director
Morgan Stanley & Co., Inc.

Ray J. Groves
Chairman and Chief Executive
Ernst & Whinney

Alan R. Gruber
Chairman & Chief Executive Officer
Orion Capital Corporation

Edward L. Hennessy, Jr.
Chairman of the Board
Allied Corporation

Gregg A. Jarrell, Ph.D.
Senior Economist
Lexecon Inc.

Robert P. Jensen
Chairman & Chief Executive Officer
E.F. Hutton LBO Inc.

Martin Lipton, Esq.
Wachtell, Lipton, Rosen & Katz

Robert E. Rubin
Partner
Goldman, Sachs & Co.

Irwin Schneiderman, Esq.
Cahill Gordon & Reindel

John W. Spurdle, Jr.
Senior Vice President
Morgan Guaranty Trust Company

Jeff C. Tarr
Managing Partner
Junction Partners

Bruce Wasserstein
Managing Director
The First Boston Corporation

EXHIBIT B

SEC Advisory Committee on Tender Offers
Agenda of Issues

Objectives: To review techniques for the acquisition of control of public companies ("takeovers") and the laws applicable thereto in terms of the best interests of all shareholders (i.e., shareholders of all corporations, whether potential acquirors, target companies or bystanders) and to propose specific legislative and regulatory improvements for the benefit of all shareholders.

I. Definition of Activities to be Reviewed.

The Committee has determined that, given the interrelationship of the various techniques to acquire control and the consequences of regulating one method of acquisition without taking into account the effect of such regulation on the relative advantages and disadvantages of other acquisition methods, it is necessary to consider the whole spectrum of acquisition techniques. The Committee recognizes, however, that given the anticipated date of its report to the Commission, it may not address in detail the full range of regulations, state and federal, applicable to proxy solicitations and mergers, but rather may focus on those issues that are common to such transactions and acquisitions of control through purchases of equity from investors.

II. Economics of Takeovers and their Regulation.

A. What is the economic effect of takeovers on:

1. acquirors and their shareholders - for example, what happens to an acquiror's financial condition, results of operations and stock price following an acquisition?

2. target companies and their shareholders - for example,

    a. do takeovers provide a useful means of providing better management; and

    b. does the prospect of takeover cause management to emphasize short-term results at the expense of long-term growth?

B. What is the relative effect of the following factors on the size and number of takeovers:

1. credit availability and policies;

2. tax policies;

3. antitrust policies;

4. market conditions;

5. general economic conditions;

6. accounting requirements (e.g., pooling, purchase, consolidation and equity accounting requirements);

7. laws applicable to change in control of regulated industries;

8. state takeover laws;

9. federal securities laws;

   a. 1933 Act (required registration of exchange offers)

   b. Williams Act

   c. other

10. state corporate law (e.g., fiduciary obligations); and

11. other?

C. What are the anticipated economic effects on acquirors, target companies, and the number and size of takeovers of adopting British type regulations that restrict or prohibit the ability of acquirors to:

1. use two-tier pricing;

2. engage in partial offers; and/or

3. engage in open market accumulation programs at some defined level?

D. What is the economic effect on acquirors, target companies, their shareholders, and the number and size of takeovers of a regulatory environment that permits or encourages "auctions" of a target company?

E. What is the impact upon shareholders of the credit used to finance takeovers? Should the extension of credit for takeovers be regulated for the benefit of all shareholders?

III. Basic Objectives of the Federal Securities Laws Applicable to Takeovers.

The following issues are to be considered as an integral part of the Committee's consideration of the issues arising under captions IV, V, VI and VII.

Who should be protected under federal securities laws, what should the objectives of such regulation be and what premises should govern the balancing of these objectives?

A. Protection of shareholders (*e.g.*, disclosure, proration, equality of treatment, substantive fairness).

B. Preservation of flexibility of business judgment for both the acquiror and target company.

C. Auctions of target companies.

D. Unfettered transfers of control.

E. Market liquidity and depth, efficiency in pricing. (Should takeovers be considered another dimension of market liquidity and thereby promoted under a mandate to extend market depth with full disclosure, promptness and reasonable cost?)

F. Ability of management to find alternative to takeover partners.

G. Neutrality (*i.e.* that the law have neither as its objective or effect, taking into account other regulatory objectives, the deterrence or promotion of takeovers).

IV. Regulation of Acquirors of Control.

A. To what extent can the procedures specified by law be made more uniform so that the current distinction between cash transactions and those using securities may be minimized? To what extent can the concept of integration of the 1933 and 1934 Acts be applied in the takeover area (where shareholders are compelled to make an investment decision) to streamline the procedures and disclosure required in connection with exchange offers and mergers?

B. Disclosure.

The primary purposes of the Williams Act are to assure that target company shareholders have the time and information to make informed investment decisions.

1. Are these purposes achieved by the current regulatory system?
   a. Is the current required disclosure meaningful and of use to most shareholders?
   b. Can some disclosure be eliminated or streamlined without lessening its effectiveness?
2. Should time and information continue to be the primary objectives of the law? Do such requirements serve the best interest of all shareholders?
3. What changes should be made in current disclosure requirements if disclosure continues to be a primary objective? For example:
   a. Should pro forma information be required in partial or proposed multiple step transactions?
   b. Should the accounting requirments with respect to purchase and pooling, consolidation and equity reporting be revised?
   c. Should tax disclosure be expanded and opinions of counsel on tax matters be required?
   d. Should projections of the target company given to the acquiror be required to be disclosed in its disclosure materials?
   e. Should tender offer materials be reviewed by the Commission prior to use as are proxy soliciting materials and registration statements used in connection with exchange offers and mergers?

4. Do acquirors and target companies have sufficient access to shareholders in an efficient, timely manner?

5. Do technological developments need to be taken into account in defining timing and disclosure requirements?

6. Do the current requirements under section 13(d) of the 1934 Act need revision? Is the disclosure required in the Schedule 13D useful to shareholders? Should acquirors be permitted to continue to purchase securities before the Schedule 13D is filed after the 5% threshold is reached? Should the criteria for reporting obligations be expanded to include any purchase that is part of an intended acquisition of control.

C. Terms of the Acquiror's Offer.

What substantive regulation should there be of the terms of the offer?

1. Price.

   a. Should it be required to be fair and if so by whose determination?

   b. Should all shareholders accepting the offer be entitled to the highest price paid in the offer?

   c. Should Dutch Auctions be permitted or encouraged?

   d. Should there be a limitation on, or prohibition of, two-tier pricing?

2. Limited Offers.

   a. Should partial tender offers be permitted?

   b. If partial offers are permitted, should shares be required to be accepted pro rata?

   c. Should there be a limitation on open market accumulation programs?

3. Minimum Offering Period.

Should there be a minimum offering or solicitation period? If so, for what period?

4. **Withdrawal Rights.**

   Should withdrawal rights be required? If so, on what basis?

5. **Should states law rights of appraisal be incorporated in federal law?**

D. **Approval of Acquiror's Shareholders.**

Should the acquiror have to obtain the prior approval of its shareholders of proposed major acquisitions and attendant financings?

V. Regulation of Opposition to Acquisition of Control.

A. Should state corporate law fiduciary obligations applicable to the board of directors be the principal means by which its activities are regulated? If so, should the "business judgment" rule continue to be the principal applicable standard?

B. If the business judgment rule is the appropriate standard against which to measure the board's actions, should there be different requirements (i.e. restrictions, requirements of shareholder approval or prohibition) with respect to one or more of the following actions:

1. Pac-man defense;
2. sales of "crown jewels";
3. target tender offers for their own shares;
4. use of employee benefit plans to defeat or deter tender offers;
5. "golden parachutes" and "silver wheelchairs" (i.e. employment and severance provisions that take effect upon a change in control);
6. lock-ups; leg-ups (e.g., sales of blocks of shares or options on shares to frustrate takeovers);
7. "shark repellents" (charter and by-law amendments to discourage takeover attempts);
8. "scorched earth" policies;

9. litigation; and

10. other defensive maneuvers?

C. Should the repurchase of shares by an issuer at a premium be proscribed?

VI. Regulation of Market Participants.

A. Is there a need to limit or prohibit short tendering, hedged tendering, double tendering?

1. What is the impact on the market and on the tender offer process of such practices?

2. Do such practices inordinately disadvantage the non-professional investor? If so, are there benefits to such investors that outweigh such disadvantages?

3. Is there a need to regulate substantively the tender guarantee mechanism?

B. Options.

Do problems exist in the tender offer process as the result of or because of the options markets? E.g., can and should there be a limitation on or other regulation of uncovered call writing during tender offers?

C. Clearing Systems.

Should regulations be adopted to require the use of depository book entry systems and/or require clearing corporations to maintain continuous netting programs during tender offers and to adopt uniform closeout and liability notice programs?

D. Risk Arbitrage.

Is there a need for substantive regulation of the activities of risk arbitrageurs?

VII. Interrelationship of Various Regulatory Schemes.

A. Should the Committee consider substantive issues with respect to tax, banking, antitrust, ERISA, etc. or limit itself to considering whether in general the various regulatory schemes eventually should or could be coordinated procedurally and/or substantively?

B. What is the proper relationship of federal and state securities and corporate laws and laws applicable to regulated industries?

1. Should there be state regulation of third party acquisitions of securities from shareholders (e.g., new Ohio statute)?

2. At present acquirors' activities are, as a practical matter, principally restricted by the federal securities laws, while the target's responses are, as a practical matter, principally subject to state regulation. Is this appropriate? If not, what should be done about it? What is the appropriate relationship between the federal securities laws and state laws applicable to changes of control of regulated industries?

VIII. Additional Issues.

A. See the additional issues raised by 12 members of the Senate Banking Committee in the attached letter.

B. What Commission enforcement presence is possible or appropriate, given the timing of control acquisitions? Are changes needed in the applicable laws to permit an effective enforcement presence?

C. To what extent do continuing changes in the law applicable to takeovers create inordinate difficulties for participants and shareholders?

EXHIBIT C

July 8, 1983

John S.R. Shad
Chairman
Securities and Exchange Commission
Washington, D.C. 20549

Dear Chairman Shad:

We are enclosing the final report of the Commission's Advisory Committee on Tender Offers which was established on February 25, 1983. The eighteen members of this Advisory Committee met six times in full session. Countless meetings of six sub-committees were held to prepare recommendations to the full body. We had the benefit of extensive experience of our individual members in completing our assignment within our original time frame.

The summary report emphasizes that we concentrated our work and recommendations on shareholders' interests. We are cognizant, however, of interest in takeovers on broader governmental, societal, jurisdictional planes and have touched on these issues in our work. We specifically address some questions put to us through the Commission that express Congressional concerns.

Our recommendations are detailed, technical and comprehensive. We expect the Commission to put them in place by rule making or by recommending legislation, or regulation, as may be required, as they stand. They are designed to be an integral and cohesive body.

I would like to point out the fundamental bases upon which our recommendations rest. There are other technical solutions which are consistent with our fundamental policy objectives. Throughout the meetings of the Committee we encouraged diversity of opinion and dissent. One of our functions was to bring out a number of ideas which might otherwise have become buried in a carefully negotiated majority view. We hope the Commission will draw upon this diversity of views in reaching your ultimate decisions.

The Committee respects the free market forces in the operation of the U.S. securities markets. Academic evidence is widespread that the takeover process is at least not demonstrably harmful to shareholders and some evidence points to its systematic benefits. We would be reluctant to restrict a process which seems to work reasonably well with the possibility that we might incur some unintended harm. The Committee is humble in its ability to anticipate all of the takeover innovations that are likely to occur: good and bad. Our instincts led us to rely upon competitive markets as the ultimate regulator for the unforeseen specifics that may affect security holders. Our recommendations should promote private investment systems rather than hamper capital flows by heavy reliance upon rule making. We are attracted to solutions which are characterized by flexibility, simplicity and lower costs.

A theme running through our recommendations is to promote the disclosure of meaningful information to all investors. The tender offer process seems the best way available to us of insuring that terms, price and conditions are made available equally to all shareholders in a timely fashion. We suggest that purchases above 20% ownership be offered to all shareholders through the tender process.

We resist the temptation to bar substantial partial positions in companies. In most instances, we would expect that the acquisition of control would be accompanied by the purchase of all shares. There are circumstances in this country, as in international markets, where partial participation establishes business relationships which encourage cooperation and productive sharing of skills. We would not wish to alter these affiliations. We do, however, recommend that the partial positions receive somewhat less favored treatment than purchases which are contemplated to be for an entire company.

We are introducing an improvement in shareholder democracy in the form of advisory votes. We do believe that shareholders should have a mechanism to express their periodic will on charter provisions which may limit conditions under which their stock may be sold. Company directors, on the other hand, should not be bound to act against their business judgment in the shareholder interest. We do believe that the advisory vote concept will become a useful device in measuring shareholder sentiments.

We encourage procedures which will equate the offering of cash and securities. A number of purchases are accomplished initially for cash because Commission procedures are simplified for cash, and then are converted later into securities. Should cash and securities be administratively equated in the first instance, the latter potentially cumbersome and expensive step can be eliminated.

Throughout our discussions we have argued for simplicity in the procedures which may be required. This simplification may in some measure counteract the almost natural attraction to an elegance of rule making to guard against a number of perceived evils, especially those of recent anecdotal evidence.

Documentation by academic sources, business reports and the Commission staff were very helpful in our deliberations. We benefited from a review of takeover practices in other countries which included generous personal visits by United Kingdom and Canadian representatives.

The committee would have been unable to complete its work without the competence, diligence and hard work of the staff assigned to it. David Martin, Secretary to the Committee, did excellent work in keeping us administratively on track. Linda Quinn, Associate Director, diplomatically functioned in a continuing and important role.

Finally, we hope that the Commission and its staff will draw upon the Committee members for their advice and counsel in the future as you wish. Although we are disbanded with this report, our interest has not lessened and our willingness to serve remains keen.

Sincerely,

Dean LeBaron
Chairman
Securities and Exchange Commission
Advisory Committee on Tender Offers

EXHIBIT D
March 29, 1984

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-20799 - File No. S7-903]

Short Tendering Rule

AGENCY: Securities and Exchange Commission.

ACTION: Final rulemaking.

SUMMARY: The Commission has determined to adopt certain amendments to Rule 10b-4 under the Securities Exchange Act of 1934, the short tendering rule. These amendments will impose additional ownership requirements for persons tendering securities in response to tender offers for those securities, clarify the provisions of the rule, and limit the types of offers to which the rule applies. The Commission has decided not to deregulate short tendering entirely.

EFFECTIVE DATE: (Insert date - 30 days after publication in the Federal Register).

FOR FURTHER INFORMATION CONTACT: M. Blair Corkran, Esq. (202-272-2853) or Kevin A. Corcoran, Esq. (202-272-2828), Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission is adopting amendments to Rule 10b-4 [§240.10b-4] under Section 10(b) of the Securities Exchange Act of 1934 (the "Act"), 15 U.S.C. 78j(b). Rule 10b-4 (the "Rule") was adopted by the Commission in 1968 [1] for the purpose of prohibiting "short tendering," *i.e.*, tendering more shares than a person owns in order to avoid or reduce the risk of *pro rata* acceptance in tender offers for less than all the outstanding securities of a class or series. The amendments being adopted are substantially the same as those proposed for comment on August 21, 1981. [2] Among other things, the amendments prohibit the practice of hedged tendering, *i.e.*, tendering and then selling a portion of the tendered shares in the market.

I. BACKGROUND

In making a tender offer for securities of the corporation that is the subject of the offer, the bidder usually offers as consideration either cash, its own securities, or a combination of both. Tender offers can be for all the outstanding securities of the subject company or for a lesser amount.

Offers for less than all of the outstanding shares involve a risk to the securityholder of the subject company that not all of the securities that the securityholder tenders will be accepted. 3/ Before the adoption of Rule 10b-4, certain securityholders tendered more securities than they owned in order to diminish this risk. By tendering a greater number of securities than they owned, and by guaranteeing their own tenders, market professionals were able to secure acceptance of a disproportionately larger number of the securities owned and tendered by them than could be secured by other persons who tendered only securities that they owned. 4/ Accordingly, the Commission adopted Rule 10b-4 in May 1968 5/ for the specific purpose of prohibiting short tendering. Rule 10b-4 makes it a "manipulative or deceptive device or contrivance," as used in Section 10(b) of the Act, for any person, in response to an offer or invitation for tenders of any security, to tender securities

---

[1] Securities Exchange Act Release No. 8321 (May 28, 1968), 33 FR 8269 (1968).

[2] Securities Exchange Act Release No. 18050 (August 21, 1981), 46 FR 43459 (1981) ("Proposing Release").

3/ When tendered securities are accepted on a *pro rata* basis, the offeror accepts only a percentage of the securities tendered by each securityholder. The percentage is calculated from a fraction whose numerator represents the total number of securities accepted and whose denominator represents the total number of securities tendered.

4/ *See* Testimony of Chairman Manuel F. Cohen in Hearings *on* S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 198-99 (1967).

5/ *See* note 1 *supra*. Rule 10b-4 was adopted on May 28, 1968, two months before the passage of the Williams Act on July 29, 1968.

that he does not own. Ownership is defined in paragraph (b) of the Rule. The Rule applies to all tender offers whether made by a third party or by the issuer of the securities sought. 6/

II. NEED FOR THE AMENDMENTS

By prohibiting short tendering, Rule 10b-4 was designed to promote equality of opportunity and risk for all tendering securityholders. In the years since the Rule's adoption, it has become apparent that simply requiring a tendering person to tender from a long position does not reach certain conduct that has the same purpose and effect as short tendering. Under the Rule, arbitrageurs are able to tender to an offer involving prorationing or selection by lot and then sell into a market that reflects the offer the portion of shares that they estimate will be returned unaccepted by the bidder. The shares sold may, in turn, be bought and tendered by another arbitrageur who may also hedge his tender by selling a portion of the shares. As a result, the same shares are effectively tendered by two (or more) shareholders and those shareholders who tender and do not engage

---

6/ Although tender offers by an issuer are exempt from the provisions of Section 14(d), they are subject to the antifraud provisions of Section 14(e) of the Act. In addition, issuer tender offers are subject to Rule 13e-4, which was adopted in 1979. Securities Exchange Act Release No. 16112 (August 19, 1979), 44 FR 49406 (1979).

in any hedging continue to experience the same dilution of their pro rata acceptance that occurred before the Rule was adopted. 7/

To address this concern, the Commission on August 21, 1981, published for comment a proposal to amend Rule 10b-4 to require that a tendering person own the tendered securities not only when they are tendered, but also at the end

---

7/ For example, assume there is a tender offer for less than all the outstanding securities of the target and that A and B each owns 200 shares of the subject security and expects that the offeror will accept on a pro rata basis 60% of the securities tendered. If A tenders his 200 shares, and then sells 80 shares, he will (assuming the 60% expectation proves correct) have 120 shares accepted by the offeror, or 100% of the securities that he owns at the time the proration period ends. In contrast, if B simply tenders his 200 shares and does not engage in any hedging (possibly because he cannot borrow the subject security), he will have only 120 of his shares accepted and 80 shares will be returned unaccepted to him.

It seems anomalous that A, who would have engaged in a prohibited short tender if he had sold the 80 shares immediately before tendering 200 shares, can accomplish precisely the same result under the current Rule by waiting to sell the 80 shares until a moment after tendering. Furthermore, the 80 shares A tendered and then sold may be bought by an arbitrageur or other purchaser who will tender the same shares to the bidder and thereby increase the likelihood or degree of prorationing. If that occurred, it would reduce the number of tendered securities that would be accepted from other securityholders.

of the proration period. 8/ Since consistent treatment of short tendering and hedged tendering could also be achieved by deregulation and because it has been argued that deregulation might result in broader economic benefits, the Commission also requested comment on the effects, costs and benefits that would result from a deregulation of short tendering.

More recently, the Commission formed an Advisory Committee on Tender Offers ("Advisory Committee"). The Advisory Committee considered a wide range of matters relating to the regulation of tender offers, including the appropriate regulatory treatment of short and hedged tendering. The Advisory Committee recommended that both short and hedged tendering should be prohibited. 9/

The Commission has considered the comments received in response to the Proposing Release 10/ and the recommendations

---

8/ See note 2 supra. The Commission also withdrew an earlier proposal to amend Rule 10b-4. See Securities Exchange Act Release No. 14157 (November 9, 1977), 42 FR 59280 (1977).

9/ See Report of Recommendations of the Advisory Committee on Tender Offers ("Advisory Committee Report") at 47.

10/ Pursuant to the Commission's request for comment, 14 letters of comment were submitted, as follows:

(Footnote continued)

of the Advisory Committee. For the reasons set forth in this release, the Commission is adopting the amendments to Rule 10b-4 as proposed. The Commission has also determined not to deregulate short tendering, for the reasons set forth in Section IV, below.

A majority of the commentators believed that hedged tendering should be proscribed. A substantial minority of commentators argued that hedged tendering should not be curtailed. They asserted that hedged tendering enables arbitrageurs to minimize prorationing risks and therefore to bid higher for securities during a tender offer. This, in turn, benefits those securityholders who wish to avoid proration risk by selling all of their shares in the market at a known price.

The benefits to such securityholders, however, come at the expense of those shareholders who tender without hedging and thereby suffer from the expansion of the proration pool. 11/ The Commission believes that the impact of hedged tendering is unfair because, as a practical matter, hedged tendering is not

---

(Continued footnote)

law firms and associations (4); industry associations (1); self-regulatory organizations (1); broker-dealers (3); Congressional (1); individuals (4). The comment letters are available for public inspection and copying at the Commission's Public Reference Room (see File No. S7-903).

11/ See note 7 supra.

available to most shareholders. Of the eight commentator. who addressed the question posed in the Release as to the availability of hedged tendering to the public, only one suggested that hedged tendering was available to all shareholders, and that commentator conceded that small investors would have difficulty borrowing stock during a tender offer if demand were tight. 12/

The Commission recognizes that hedged tendering and short tendering may be distinguished, largely because the hedged tenderor owns the tendered securities at the moment of tender. The Commission believes, however, that the two practices are closely analogous in terms of their purpose, availability, and effect on other shareholders who tender, and that hedged tendering should therefore be proscribed for essentially the same reasons that support the prohibition of short tendering.

12/ If a tenderor has physically tendered his shares, other shares must be borrowed to complete any subsequent short sale. If the tender is by guarantee, the tenderor may be able to sell and deliver the shares that he owns (subject to any restriction imposed by the guarantor), but would need to borrow shares to fulfill the guarantee, at least in those offers where the bidder requires that all shares tendered by guarantee be submitted.

III. SUMMARY OF AMENDED RULE

The amended Rule is designed to prohibit hedged tendering by the additional requirement that all tendering securityholders be "net long" the amount of securities tendered at the end of the proration period, or on the last day securities may be tendered in order to be accepted by lot where that method of acceptance is used. In addition, the Rule has been amended to clarify certain of its provisions and to limit its application to partial offers. 13/ The provisions of the rule are discussed below.

Paragraph (a)(1) sets forth the definition of ownership, which is essentially unchanged from current Rule 10b-4(2)(b), except for a revision to reflect the use of "equivalent security" as a defined term in paragraph (a)(2). The ownership definition has been refined to provide that a person who might otherwise tender securities will be deemed not to own the securities, and thus will be prohibited from tendering them, if he has entered into any arrangement or agreement (other than stock loans or the writing of exchange-traded

---

13/ A partial offer is generally an offer for less than the total number of outstanding securities of a particular class or series or one where the bidder makes a bid for all the outstanding securities of a particular class or series but offers different consideration for a specified number of the outstanding securities than it offers for the remaining outstanding securities of that class or series.

call options) whereby another person can tender those securities under the Rule. Thus, for example, a person who has title to subject securities would not be permitted to tender them if he has (i) entered into an unconditional contract to sell them or (ii) written an over-the-counter call option on them and caused the holder to have the reasonable belief set forth in paragraph (a)(2) of the Rule.

Paragraph (a)(2) defines equivalent security to include (1) options, warrants, and rights issued by the person whose securities are the subject of the offer and (2) any other option to acquire the subject security, but only if the holder reasonably believes that the maker or writer of the option has title to and possession of the subject security and upon exercise will promptly deliver the subject security. This language tracks in all significant respects the proviso in existing Rule 10b-4(a)(1). An option traded on a national securities exchange would not be included within the definition of equivalent security since the holder of such an option cannot know that the maker or writer of the option has "title to and possession of" the underlying security within the meaning of the Rule. Since an unlimited number of options can be written on an uncovered basis, Rule 10b-4 does not permit listed options holders to tender unless they have exercised those options. The exclusion of options that are traded on a national securities exchange from the definition of equivalent securities represents a codification of prior staff interpretations of Rule 10b-4.

The term "tender" is defined in paragraph (a)(4) to encompass all methods by which a person can affirmatively respond to a request or invitation for tenders. Current Rule 10b-4(a)(1) refers to tendering for a person's own account; paragraph (a)(2) refers to tenders or guarantees on behalf of others. It has thus been possible to read Rule 10b-4 as prohibiting guarantees of delivery for a person's own account, although it is the Commission's understanding that market professionals routinely have employed so-called "self-guarantees" as a method of tendering securities purchased but not yet received. The definition of "tender" in paragraph (a)(4) specifically includes "guarantee" and thus eliminates any implication in the current Rule that self-guarantees are improper. 14/

Paragraph (b) of the Rule limits the substantive provisions to partial offers. In addition, new paragraph (c) would expressly exclude any partial offer where acceptance of tenders is not primarily by lot or on a pro rata basis

---

14/ If broker-dealers were unable to utilize self-guarantees, they could not tender securities purchased "regular-way" in the last five days of a partial offer, unless they secured the guarantee of another broker-dealer. There would not appear to be any regulatory rationale for imposing such a requirement.

for a specified period. 15/

Paragraph (b) of the amended Rule contains the substantive provisions of the Rule and covers acts by "any person acting alone or in concert with others, directly or indirectly." The phrase "directly or indirectly," together with the "in concert" language, is intended to make it clear that persons may not do indirectly what they may not do directly, and thereby to emphasize that indirect forms of short tendering are prohibited. This does not, however, effect a substantive change in the Rule, in view of the provisions of Section 20(b) of the Act. 16/

Paragraph (b)(1) incorporates the ownership provisions of current Rule 10b-4(a)(1), considerably abbreviated through the use of defined terms. In addition, paragraph (b)(1) makes it unlawful for any person to tender any

---

15/ Incidental prorationing would not bring an offer within the coverage of the Rule. Such incidental prorationing might occur, for example, when some, but not all, securities at the highest acceptable price were accepted in an offer conducted on a "lowest price first" basis. Thus, Rule 10b-4, as amended, does not apply to most tender offers for municipal and corporate debt securities. Each of the commentators addressing the issue favored limiting the application of Rule 10b-4 to partial offers.

16/ Section 20(b) of the Act [15 U.S.C. 78t(b)] makes it unlawful for "any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of [the Act] or any rule or regulation thereunder through or by means of any other person."

security unless he owns the securities tendered both at the time of tender and at the end of the proration acceptance period. This provision assures that the pro rata determination more fairly and accurately reflects actual ownership of tendered securities at that time. Securityholders who tender and do not thereafter sell the securities are unaffected by this amendment. A securityholder who tenders the subject security, and thereafter during the proration period sells all or a portion of the subject securities that constituted his net long position is required by this provision either to repurchase sufficient shares, or to withdraw shares from his tender, in order to comply with the net long proviso at the end of the proration period. The "end of the proration period" is the time after which securities would not be accepted by the bidder on a pro rata basis. Sales of subject securities occurring after the proration period are not prohibited since they do not affect the pro rata calculation.

In the case of a tender based upon ownership of an equivalent security, the Rule, as amended, clarifies the intent of the current Rule that equivalent securities need be converted, exchanged, or exercised only to the extent required by the bidder's terms of acceptance.

Paragraph (b)(2), which covers guarantees of tender, is largely comparable to current Rule 10b-4(a)(2), again simplified through the use of defined terms. The current standard of inquiry imposed upon guarantors by Rule 10b-4 remains unchanged. A guarantor must have "a reasonable belief that, upon information furnished by the person on whose behalf the tender is made," the person could tender in accordance with the provisions of the Rule.

Paragraph (b)(3) prohibits a tendering securityholder from tendering the same securities to more than one partial offer at the same time, i.e., multiple tendering. Some commentators believed that allowing multiple tendering would allow investors to have greater flexibility in choosing the best offer. The Advisory Committee, however, specifically recommended that multiple tendering be prohibited. 17/ The Commission agrees with the Advisory Committee and with the majority of commentators that prohibiting multiple tendering will prevent the confusion and possible deception to the market and to bidders that could otherwise arise, as well as the potential unfairness to certain securityholders for whom this practice may not be available.

Paragraph (d) provides a mechanism for obtaining exemptive relief to the extent that there may be factual situations that would justify the granting of an exemption upon a proper application.

17/ Advisory Committee Report at 49.

IV. WITHDRAWAL OF DEREGULATORY ALTERNATIVE

In view of the possibility that Rule 10b-4 might impose burdens that exceed its benefits, the Commission in the Proposing Release solicited public comment on whether short tendering is an appropriate subject for complete or partial deregulation. Virtually all of the commentators who addressed this issue were opposed to the deregulation of short tendering.

The commentators asserted two very different reasons for retaining the prohibition of short tendering. Several commentators, as well as the Advisory Committee, emphasized the continued validity of the original purpose of Rule 10b-4, *i.e.*, the unfairness of allowing market professionals, by guaranteeing delivery of securities they do not own, to gain acceptance of a disproportionate number of shares owned by them at the expense of non-professionals who cannot engage in this practice.

Other commentators suggested that short tendering would exacerbate the confusion that can exist in the market for target stock, particularly in the context of competing offers. These commentators argued that absent the requirement that a tenderor own the shares tendered, there would be no limit upon the amount of shares that could be tendered.

Considering this nearly unanimous adverse comment, and mindful of the need to fulfill the important investor protection goals of the Williams Act, the Commission has decided not to rescind Rule 10b-4.

V. REGULATORY FLEXIBILITY ACT STATUS

The Chairman of the Commission certified that the amendments to Rule 10b-4 will not have a significant economic impact on a substantial number of small entities. The Commission did not receive any comments concerning the Chairman's certification.

VI. COMPETITION

Pursuant to Section 23(a)(2) of the Act, the Commission has considered the impact that the amended rule will have on competition. For the reasons stated above, the Commission finds that compliance with the rule will not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

VII. STATUTORY BASIS

The amendments to Rule 10b-4 are promulgated under the Act, 15 U.S.C. 78a et seq., and particularly Sections 3(b), 10(a), 10(b), 14(e), 15(b) and 23(a) of the Act [15 U.S.C. 78c(b), 78j(a), 78j(b), 78n(e), 78o(b) and 78w(a)].

List of subjects in Part 240

Reporting and recordkeeping requirements, Securities.

VIII. TEXT OF RULE

On the basis of the above discussion and analysis, the Commission is amending Part 240 of Chapter II of Title 17 of the Code of Federal Regulations by revising §240.10b-4 to read as follows:

PART 240--GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

§240.10b-4 Short tendering of securities.

(a) Definitions. For purposes of this section: (1) A person shall be deemed to own a subject security or an equivalent security if neither he nor his agent has entered into an arrangement or agreement (other than one for the lending of securities or the writing of a call option that is traded on a national securities exchange) whereby any other person may tender that security or be deemed to own it and (i) he or his agent has title to it, or (ii) he has purchased, or has entered into an unconditional contract, binding on both parties thereto, to purchase it but has not yet received it, or (iii) he has an option that is traded on a national securities exchange to purchase it and has exercised that option, or (iv) in the case of a subject security, he has converted, exchanged, or exercised an equivalent security that he owned (within the meaning of (i) or (ii) above). For the purpose of determining ownership as of the end of the proration period, securities that have been tendered and not withdrawn are deemed to be owned as of the end of the proration period. Provided, however, that a person shall be deemed to own a security for purposes of this rule only to the extent that he has a net long position in such security.

(2) The term "equivalent security" means (i) any security (including any option, warrant, or other right to purchase the subject security), issued by the person whose securities are the subject of the offer, that is immediately convertible into, or exchangeable or exercisable for, a subject security, or (ii) any other right or option (other than an option that is traded on a national securities exchange) that entitles the holder thereof to acquire a subject security, but only if the holder thereof reasonably believes that the maker or writer of the right or option has title to and possession of the subject security and upon exercise will promptly deliver the subject security.

(3) The term "subject security" means a security that is the subject of any tender offer or request or invitation for tenders.

(4) For purposes of this rule, a person shall be deemed to "tender" a security if he (i) delivers a subject security

pursuant to an offer, (ii) causes such delivery to be made, (iii) guarantees delivery of a subject security pursuant to a tender offer, (iv) causes a guarantee of such delivery to be given by another person, or (v) uses any other method by which acceptance of a tender offer may be made.

(b) It shall constitute a "manipulative or deceptive device or contrivance" and a "fraudulent, deceptive, or manipulative act or practice" as those terms are used in sections 10(b) and 14(e) of the Act, respectively, for any person acting alone or in concert with others, directly or indirectly, to tender any subject security in a partial offer:

(1) For his own account unless at the time of tender, and at the end of the proration period or period during which securities are accepted by lot (including any extensions thereof), he owns (i) the subject security and will deliver or cause to be delivered such security for the purpose of tender to the person making the offer within the period specified in the offer, or (ii) an equivalent security and, upon the acceptance of his tender, will acquire the subject security by conversion, exchange, or exercise of such equivalent security to the extent of such acceptance and, within the period specified in the offer, will deliver or cause to be delivered the subject security so acquired for the purpose of tender to the person making the offer; or

(2) For the account of another person unless the person making the tender (i) possesses the subject security or an equivalent security, or (ii) has a reasonable belief that, upon information furnished by the person on whose behalf the tender is made, such person owns the subject security or an equivalent security and will promptly deliver the subject security or such equivalent security for the purpose of tender to the person making the tender.

(3) If the same security has been tendered in response to any other partial offer, unless such other tender has been withdrawn.

(c) This rule shall not apply to a partial offer where tenders are not accepted either by lot or on a pro rata basis for a specified period.

(d) This rule shall not prohibit any transaction or transactions if the Commission, upon written request or upon its own motion, exempts such transaction or transactions, either unconditionally or on specified terms and conditions, as not constituting a manipulative or deceptive device or contrivance or fraudulent, deceptive, or manipulative act or practice comprehended within the purpose of this rule.

By the Commission.

George A. Fitzsimmons
Secretary.

March 29, 1984

DISSENT OF COMMISSIONER COX

I respectfully dissent. From the standpoint of investor protection, I cannot agree to prohibit hedged tendering. My analysis leads me to conclude that a prohibition of hedged tendering arbitrarily favors one group of investors over another.

The Division of Market Regulation's ("Division") action memorandum recognizes the argument that the practice of hedged tendering benefits target shareholders who sell their shares rather than tender them during the interim period between announcement and execution of a tender offer. Unfortunately, the Division's analysis of that argument does not go far enough. Taken to its logical conclusion the analysis shows that hedged tendering merely transfers wealth between two groups of target shareholders. The Commission has no good reason, on the basis of investor protection, to say that one of these groups of target shareholders is more deserving than the other.

As it stands, the Division's analysis concludes that the benefits from hedged tendering accruing to target shareholders who sell into the market are at the expense of target shareholders who tender shares to the bidder without hedging those tenders. This is because hedged tendering expands the proration pool and thereby decreases the fraction of the tendered shares accepted. Let us briefly consider this redistribution of wealth from tenderors to sellers.

It is useful to divide target shareholders into three groups: (1) those who tender shares to the bidder but do not hedge the tenders, (2) those who sell shares into the market where the shares may be purchased and tendered by a market professional, a risk arbitrageur, who finds it worthwhile to hedge his tender, and (3) those who neither tender nor sell, that is, a group that does nothing. To understand the effect of hedged tendering, consider first the case of an oversubscribed partial tender offer when there is no hedged tendering. In this case, the larger is the group that does nothing, the better off are the shareholders who tender because a larger fraction of their shares is accepted by the bidder. This is to say that the inaction of those who do not tender benefits those who do tender.

Next, add the practice of hedged tendering to the market. This means adding a group of risk arbitrageurs who buy shares in the market, tender those shares, and then sell short the fraction of shares they estimate will be returned under prorationing. Note that the arbitrageurs buy these shares from target shareholders who prefer to sell at the interim price rather than go through the process of tendering the shares. The demand for shares by arbitrageurs who engage in hedged tendering bids up the market price, the price becomes closer to the tender premium offered by the bidder, and this benefits the target shareholders who sell into the market.

In order to accomplish hedged tendering, the arbitrageurs have to borrow shares to cover their short sales. Who will lend shares to these arbitrageurs without charging a premium, since the shares used to pay back the lender will be worth less than the shares lent? The answer is that target shareholders who neither tender nor sell their shares and who hold the shares in street name or a similar type of account "lend" the shares to the arbitrageurs. Arbitrageurs can borrow shares from these accounts as long as they stand ready to replace the shares immediately if the beneficial owner decides to tender or sell his shares.

Besides bidding up the interim price of shares, hedged tendering enlarges the proration pool and thereby decreases the fraction of shares accepted from target shareholders who tender. Now, however, the ultimate source of the wealth transfer is clear. When there is no hedged tendering, inaction by target shareholders who neither tender nor sell transfers wealth to target shareholders who tender their shares. This is to say, there is a redistribution of wealth from inactive target shareholders to those who tender. With hedged tendering, some of that wealth is redistributed away from the target shareholders who tender to the target shareholders who sell into the market. Put another way, target shareholders who tendered without hedged tendering gained greater benefits at the "expense" of those target shareholders who neither tendered nor sold. Hedged tendering allows target shareholders who sell to avail themselves of some of the gains otherwise enjoyed by the target shareholders who tendered.

The fact that some shareholders choose neither to tender nor to sell their shares creates a potential gain for target shareholders who tender or sell. There is no objective basis on which to judge that the group of shareholders that tenders is more worthy of the gains than the group of shareholders that sells into the market. To me, shareholder protection implies that both groups of target shareholders are equally worthy and the precise division of the tender premium is best left to market processes.

A helpful analogy is the sale of used cars. Is there any basis for deciding that people who choose to sell used cars to ultimate buyers by using such methods as newspaper advertisements (analogous to target shareholders who tender) are more deserving than people who choose to sell used cars to used car dealers (analogous to target shareholders who sell into the market)? I think not.

What about the risk arbitrageurs, the market professionals who have the ability to engage in hedged tendering? They supply a service to target shareholders who decide to sell at the interim price rather than bear the risk and go through the process of tendering. The professionals bear risk and provide other services to target shareholders who sell. In a competitive market they are compensated at a competitive rate. This is to say, they benefit the target shareholders who sell and they are compensated for it. There is neither reason to think nor evidence to show that they are compensated at a supracompetitive rate.

In summary, hedged tendering is a market practice that developed in response to a demand by target shareholders who do not want to bear the burdens of tendering shares. There is no basis for the Commission to judge these target shareholders less worthy of a share of the tender premium than target shareholders who choose to tender their shares. Prohibiting hedged tendering benefits target shareholders who tender and harms target shareholders who sell. Overall investor protection is not increased by this change.

Senator WARNER. I want to congratulate the panel in complying with the Chair's request to make their observations basic to the jurisdiction of this committee. In view of the fact that this committee in all likelihood is the last on this subject, the Chair does encourage the witnesses to submit for the record such other materials as in your judgment would be beneficial to the Senate as a whole as it proceeds to address the resolution on this issue.

One of our colleagues raised the question of whether or not a causal credible chain of fact, which would link the current upward trend of interest rates to the current and immediate past activities of oil mergers. Would you care to comment on that segment? Mr. Boggs.

Mr. BOGGS. It would be our impression, simply based on the knowledge of what happens in these financial transactions as money passes from the hands of one set of lenders into the hands of another set of holders, that there should be no reason that it should have that effect.

It is our impression that the financial experts, the Treasury and others, looking at this more deeply, also come to the same conclusion that what we have seen—simply looking at the past few weeks—to say that this is known as *post hac propter hoc,* when one thing happens and then the other thing happens. This is not any good evidence.

In addition, the evidence of merger transactions over the past substantial period of time has been that there is no relationship. So we simply do not see that evidence.

Senator WARNER. Does anyone else care to address that issue?

Mr. HUBER. The advisory committee on tender offers, Senator, concluded that the tender offers do not distort the credit markets and in terms of our analysis when a bank lends money for a tender offer, that money is going to the shareholders of the target company who physically reinvest that money in other securities, so the market is rather efficient in the allocation of that borrowed fund.

Senator WARNER. There has been some speculation that the oil merger activity would result in the strengthening of the influence in the United States by the OPEC nations. Would the panel care to provide their observations on that issue. You touched on that issue in your direct testimony, Mr. Boggs, on page 13.

Mr. BOGGS. We in general do not see the evidence for that. There have been a number of theories made, two that I have heard most prominently. One is simply based on the assertion that it will reduce U.S. energy supply and thereby increase OPEC influence. As indicated, there is no evidence that it will reduce U.S. energy supply or exploration. In fact, the contrary is the case.

The second argument that we have heard made is that in some way the additional incentive to divestiture of downstream operation means that those downstream operations would be more available for purchase by foreigners.

The fact of the matter is that certainly gas stations and refineries are on the market, can be purchased at any time, and while I do not have the facts at my fingertips, and we could submit it for the record, we do not believe there is any substantial evidence of distorting foreign intervention of those markets.

[The information follows:]

FOREIGN INVESTMENT IN U.S. PETROLEUM DOWNSTREAM ACTIVITIES

There are four major foreign investors in U.S. petroleum downstream activities. They are British Petroleum, Petrofina S.A., Shell Oil and Total Petroleum. British Petroleum holds a 53 percent interest in Standard Oil of Ohio (Sohio) and the British government holds a 39 percent interest in British Petroleum. Petrofina is Belgian-owned and holds 74 percent of American Petrofina. Shell Oil is a Dutch and British group which owns over 69 percent of U.S. Shell. Total is a French corporation in which the French government holds a 35 percent interest.

In 1982, there were 175 companies with 301 refineries and 17,889,734 barrels per day of refining capacity in the U. S. There were also over 144,000 retail gasoline outlets. The four major foreign investors own about 10 percent of the refinery capacity with 1,842,706 b/d capacity and about 14 percent - 20,500 outlets - of the total gasoline outlets in the country. Refinery investments in the past few years indicate another 60,000 to 70,000 barrels per day under foreign investment, but this is a relatively small amount compared to the major investors above.

Their current downstream holdings are as follows:

SOHIO

- A total refinery capacity of 456,000 barrels per day with three refineries - Lima, Ohio (168,000 bpd), Toledo, Ohio (120,000 bpd) and Marcus Hook, Pennsylvania (168,000 bpd).
- 2,200 branded retail outlets with gasoline marketed in 20 states.

AMERICAN PETROFINA

- A total refinery capacity of 150,000 barrels per day with two refineries - Port Arthur, Texas (90,000 bpd) and Big Spring, Texas (60,000 bpd)
- 4,201 Petrofina branded retail outlets with gasoline marketed in 20 states.

SHELL OIL

- A total refinery capacity of 1,092,000 barrels per day with seven refineries - Deer Park, Texas (285,000 bpd), Wood River, Illinois (283,000 bpd), Norco, Louisiana (218,000 bpd), Wilmington, California (93,000 bpd), Martinez, California (91,400 bpd), Anacortes, Washington (91,000 bpd) and Odessa, Texas (30,000 bpd).
- 12,282 branded retail outlets with gasoline marketed in 40 states.

TOTAL

- A total refinery capacity of 144,500 barrels per day with three refineries - Ardmore, Oklahoma (62,000 pbd), Arkansas City, Kansas (42,500 bpd) and Alma, Michigan (40,000 bpd).
- 1,797 branded retail outlets with gasoline marketed in 21 states.

Information from the International Trade Administration of the Commerce Department shows a total of 10 foreign investments in the petroleum refining industry between 1979 and 1982. Five of the foreign investments amounted to $31.6 million. There is no financial data available on the remaining five investments.

The Mitsubishi Corporation made a $10 million investment in the Fletcher Oil and Refining Company of Carson, California, in 1979. The British Government made a $10.6 million investment in 1980 in Sohio's refining capabilities. Belgian investors committed $4.4 million in 1981 for plant expansion and equity interest in MacMillan Ring-Free Oil Company of New York City. The Royal Dutch Shell Group invested $6.6 million in Shell Oil Company for a new plant in 1982.

The other investments with no financial information in the petroleum refining industry are as follows:

1980

- An acquisition/merger investment by Ian W. Outerbridge of Canada in the MacMillan Ring-Free Oil Company of New York.

1981

- An acquisition/merger investment by unidentified Kuwaiti investors in the Independent Refining Corporation of Houston, Texas.

1982

- An investment in plant expansion of the refining facilities of Conoco by the Bronfman family of Canada.
- A joint venture investment by Essam Khasmoggi of Saudi Arabia in the refining facilities of Pacific Oasis of Paramount, California.
- An investment in plant expansion by the French Government in the Total refinery at Ardmore, Oklahoma.

Although the full value of these 10 foreign investments in the petroleum refining industry of the U. S. is not known for this four year period, holdings by foreign investors in U. S. downstream facilities appear to be modest.

Mr. BOGGS. Finally, if that were to be any type of problem, it could be addressed directly rather than by the extremely indirect route of saying that you cannot merge because you might have to divest some assets.

Senator WARNER. Does any other witness wish to address that issue?

Mr. GINSBURG. Senator, it occurs to me that inasmuch as the acquiring companies in the three most recently announced transactions are ARAMCO partners and the target companies are not, these acquiring companies will, to some extent, be diversifying their sources of crude and reserves. That diversification may, if anything, strengthen their hand in dealing with the OPEC cartel.

Senator WARNER. Just in the opposite manner in the case of the three specific ones?

Mr. GINSBURG. Yes, sir.

Senator WARNER. That is an important observation. Does anyone else care to observe or comment on it? Thank you.

Senator Hecht.

Senator HECHT. Thank you, Mr. Chairman.

Mr. Boggs and other panelists, from the standpoint of our energy policy, can you think of any instances where an oil company merger or group of mergers might be bad?

Mr. BOGGS. Well, just to enter into that discussion if the company doing the purchasing, we could determine in advance that it were less proficient at energy exploration or less proficient at managing its operations than the company being acquired, you might say that that is unfortunate for the economy. But that is the case for every financial transaction across the entire economy. If somebody makes a bad investment, we would just as soon that they did not, but we do not have the Government try to make that decision.

Senator HECHT. Anyone else care to comment on that?

Mr. MURIS. Well, Senator, we certainly think it would be bad if a merger had anticompetitive consequences. And, in fact, the Commission has found in certain downstream markets we are finding in pipelines and sometimes terminals there could be anticompetitive problems, but in the three mergers that we have looked at, the mergers have either been stopped or there was divestiture ordered to eliminate the anticompetitive problem.

Senator HECHT. There might be some of this in your testimony, but let me just ask you this without being redundant, are there criteria other than antitrust considerations that Congress should take a look at? Obviously not.

Mr. BOGGS. That is to say not that they are different from the range of energy issues which this committee deals with on a regular basis.

Senator HECHT. Thank you. One last question. Is the Department of Energy satisfied with the current level of oil and gas exploration in this country, Mr. Boggs?

Mr. BOGGS. Well, we would think that there are a number of continued restraints or discouragements to exploration, which we have spoken with this committee and the Congress about, natural gas price controls and regulations, OCS leasing moratoria, that type of activity, which we have pointed out on a number of occasions; we believe they are inhibiting a movement toward even greater American energy supply and American energy security.

I think it is important to note that, compared to 1980 and previous years exploration and drilling is up quite a bit over what it was and that American production today is a good bit above what was being projected for today. So we think there still are restraints beyond those imposed simply by economics, such as the two that I mentioned.

Senator HECHT. I thank you.

[Subsequent to the hearing the Department of Energy submitted the following material:]

OIL COMPANY MERGERS

A Report for the Record
Senate Energy and Natural Resources Committee

U.S. Department of Energy
Policy, Planning, and Analysis
May 1984

CONTENTS

INTRODUCTION ii

PART I - EFFECTS OF MERGERS ON DOMESTIC OIL AND GAS EXPLORATION 1

Economic Determinants of Exploration Activity 1
Expected Oil and Gas Prices 3
Geological Attractiveness of Undrilled Prospects 11
Availability of, and Access to, Domestic Prospects 12
Lease, Seismic, and Drilling Costs 12
Finding Costs 14
Taxes and Regulations 16
Interest Rates 18
Firm's Cost of Funds 20
Capacity to Absorb Risk 21
The Effect of Five Recent Mergers on Exploration 22
Other Published Studies 24
Conclusions 27

PART II - COMPETITION IN THE PETROLEUM INDUSTRY 29

Introduction 29
Outer Continental Shelf Development 30
Competition and Mergers 34
Concentration 35
Concentration Trends: Crude Oil Production 1955-82 36
Concentration Trends: Domestic Refinery Capacity 1950-82 39
Conclusions 41

CONCLUSIONS 43

FOOTNOTES 45
BIBLIOGRAPHY 47

INTRODUCTION

This report provides the Department of Energy's analysis of the potential effects of oil company mergers on domestic oil and gas exploration and on competition in the oil and gas industry.

The report comprises two parts. Part I addresses the potential effects of oil company mergers on domestic oil and gas exploration activity. This part reviews historical data and analyzes the economic determinants of domestic exploration activity. It concludes that oil company mergers will not reduce total domestic oil and gas exploration.

Part II addresses the effects of mergers on competition in the production and refining sectors of the oil industry. Part II first provides evidence of strong competition in the market for offshore leases. This market is given special emphasis here because the Outer Continental Shelf is expected to provide a critical portion of our future oil and gas supplies. This part of the report then examines the issue of competition in the entire domestic oil industry, looking specifically at concentration in the production and refining sectors. Based on two widely accepted measures of market competition, Part II concludes that the crude oil production and refining sectors of the oil industry are not highly concentrated and that mergers are not likely to reduce competition in these two markets.

Based on this two-part analysis, we find that oil company mergers will reduce neither the Nation's energy supply nor competition in the domestic oil and gas industry. We, therefore, strongly oppose any antimerger legislation, including a moratorium, that could arbitrarily interfere with the operation of capital markets and create unnecessary confusion and disruption, while adding nothing to the Federal

Government's ability under existing antitrust statutes to prevent or remedy any anticompetitive actions that might occur in the oil and gas industry. As a matter of energy policy, we currently see no reason why oil company mergers should be treated differently from other types of mergers, which frequently can strengthen the firms involved. We are concerned that unwarranted Government interference with oil company mergers would only drive available resources away from the energy sector and thus hamper the primary goal of the President's National Energy Policy Plan, which is to ensure that Americans have "an adequate supply of energy at reasonable costs."

PART I

EFFECTS OF MERGERS ON DOMESTIC OIL AND GAS EXPLORATION

Economic Determinants of Exploration Activity

This part of the report analyzes the effect of oil company mergers on a critical component of domestic energy supply--oil and gas exploration and development. First, we describe the economic factors that affect an individual firm's exploration activity and the factors that affect the overall level of domestic exploration activity in the United States. Second, we examine the effects of five recent mergers on the level of exploration activity by the companies involved in those mergers. Finally, we summarize the relevant conclusions of three published empirical studies of historical exploration activity.

The evidence supports two conclusions. First, a merger may either increase or decrease the profitability of exploration for an individual firm. Whether a newly merged firm will explore more or less than the companies that merged to form it can only be determined on a case-by-case basis. Second, oil company mergers do not affect the factors that determine the overall level of exploration activity in the United States. Although oil company mergers may affect the exploration activities of individual firms, the evidence supports the conclusion that such mergers will not reduce the _total_ level of domestic exploration activity.

To correctly analyze the effects of oil company mergers on domestic exploration activity, we must distinguish those factors that affect the total level of exploration activity in the United States from those factors that affect an individual firm's decision to explore.

The total level of domestic exploration activity is determined by the following factors:

- Expected oil and gas wellhead prices
- The geological attractiveness of undrilled domestic prospects
- Availability of, and access to, domestic prospects
- Lease, seismic, and drilling costs
- Taxes and regulations
- Interest rates

In addition to the factors listed above, the following factors also affect the level of exploration activity by an individual firm:

- The firm's cost of funds
- The firm's capacity to absorb risk
- The expected profitability of exploration relative to other company investment opportunities

Because the Department of Energy is concerned with ensuring that the total level of exploration activity is adequate and is not concerned with the business decisions of specific firms, we draw a distinction between those factors that affect the overall level of domestic exploration and those that affect the decision of a specific firm. In the following sections, each of the factors mentioned above that affect exploration activity is described.

Expected Oil and Gas Prices

Historical data show that domestic exploration activity is directly related to current and expected oil and gas prices. Figures I-A, I-B, and I-C cover the period from 1960 to 1983. These three figures display, respectively, a measure of the world oil price as indicated by the Saudi light benchmark, the number of wells and total footage drilled in the United States, and domestic expenditures on exploration and development. These figures clearly show a direct and positive correlation between world oil prices and domestic exploration activity.

Domestic exploration activity can be usefully separated into three distinct periods:

- The pre-Arab oil embargo period (1960-1973)
- The post-Arab oil embargo period (1974-1979)
- The post domestic oil price decontrol period (1980-present)

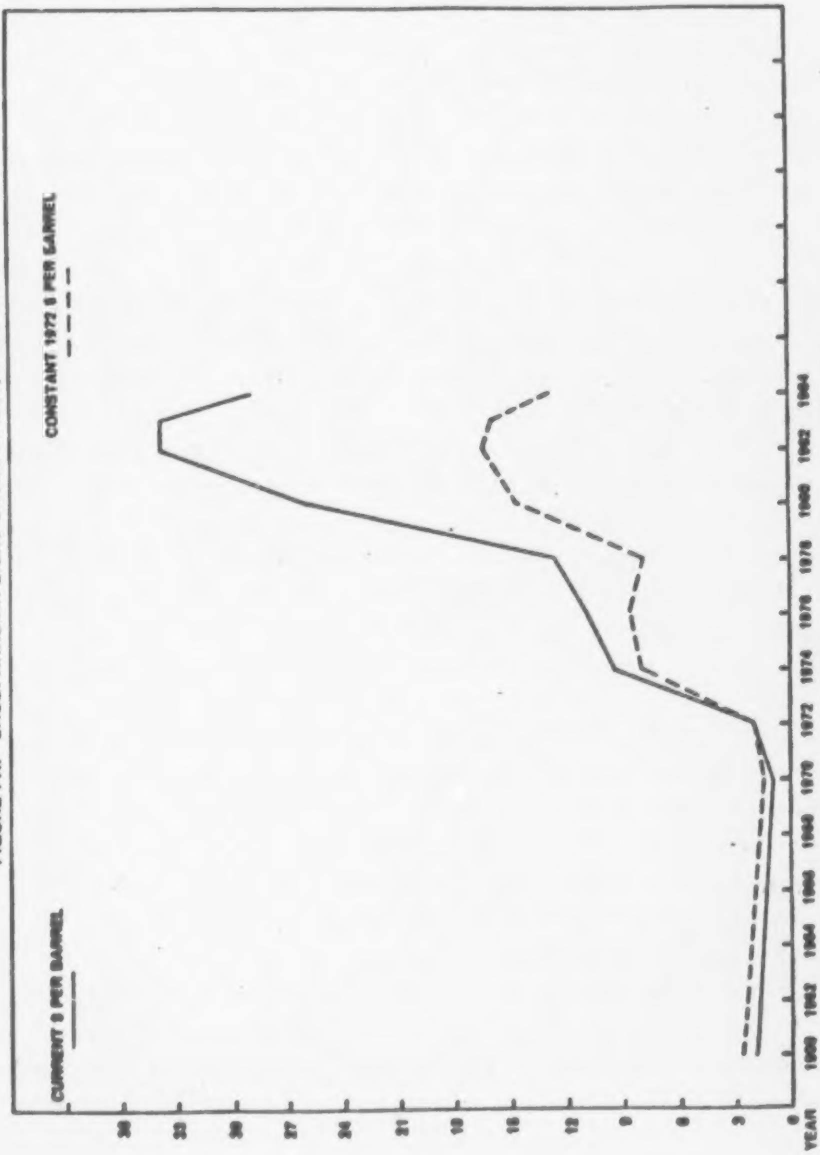
Between 1960 and 1970, domestic wellhead oil prices fell in real terms from $3.13 to $2.88 per barrel (in 1967 dollars).

During that period, domestic oil exploration activity also gradually declined. The total annual footage drilled declined from 192 million feet in 1960 to 139 million feet in 1970. The total footage drilled and the total number of wells drilled in the United States were at their lowest levels between 1970 and 1973, when world oil prices were at their lowest levels in real terms.

The oil price increases in 1973-74 reversed the long decline in U.S. oil and gas exploration. Within 6 months of the Arab oil embargo, world oil prices increased more than 285 percent. Federal price controls on domestic oil production held exploration activity below free market levels, but the price of new oil was allowed to rise from $3.89 per barrel in 1973 to $12.15 per barrel in 1978 (in current year dollars). In response, the average number of crews engaged in seismic exploration increased from 305 in 1974 to 530 in 1980. Annual drilling expenditures doubled in real terms over the same period.

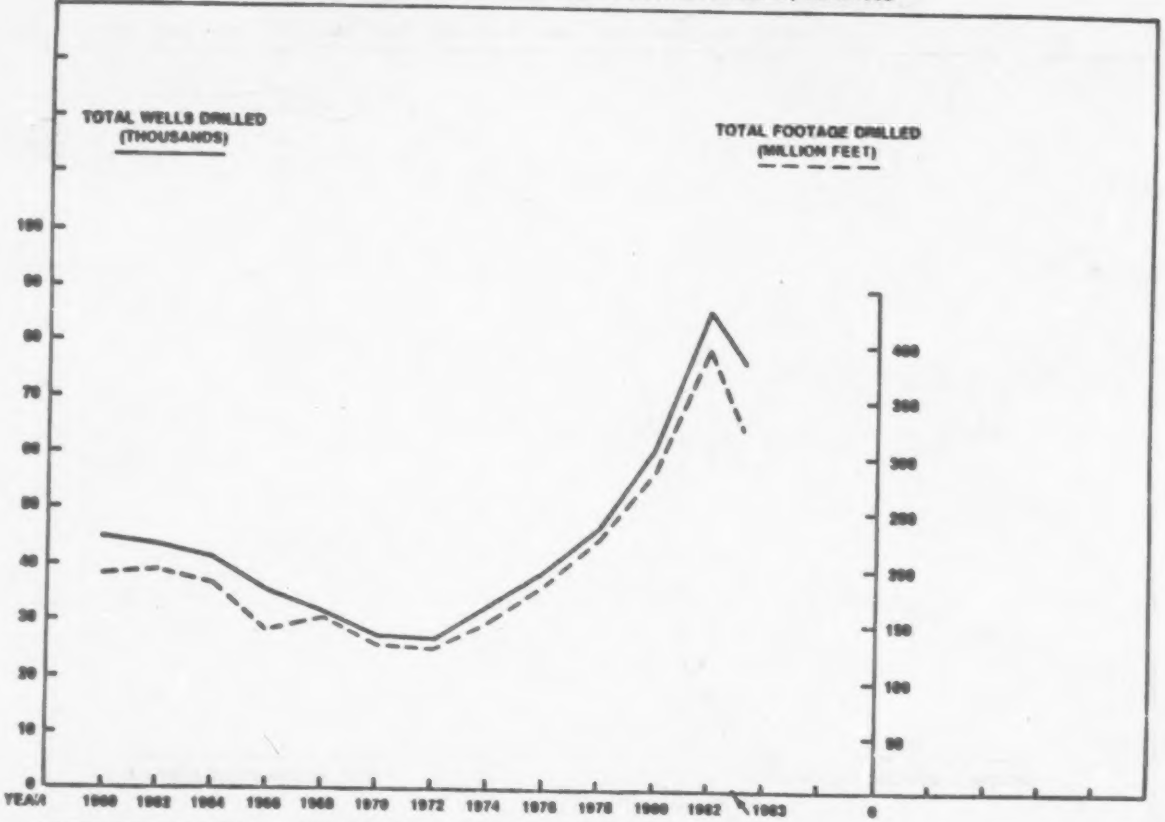
The passage of the Natural Gas Policy Act in 1978 raised the price ceiling for new gas and decontrolled certain categories of high-cost gas, thereby causing a temporary increase in domestic gas exploration. Unfortunately, the NGPA maintained price controls on most domestic natural gas production. These price ceilings and related federal regulations distorted the domestic gas market, causing consumer prices to rise to artificially high levels while simultaneously discouraging domestic gas exploration. In 1983, total gas wells drilled declined by 21.5 percent from the previous year, falling below the level for 1980.

FIGURE I-A. SAUDI ARABIAN LIGHT CRUDE PRICES, 1960-1984



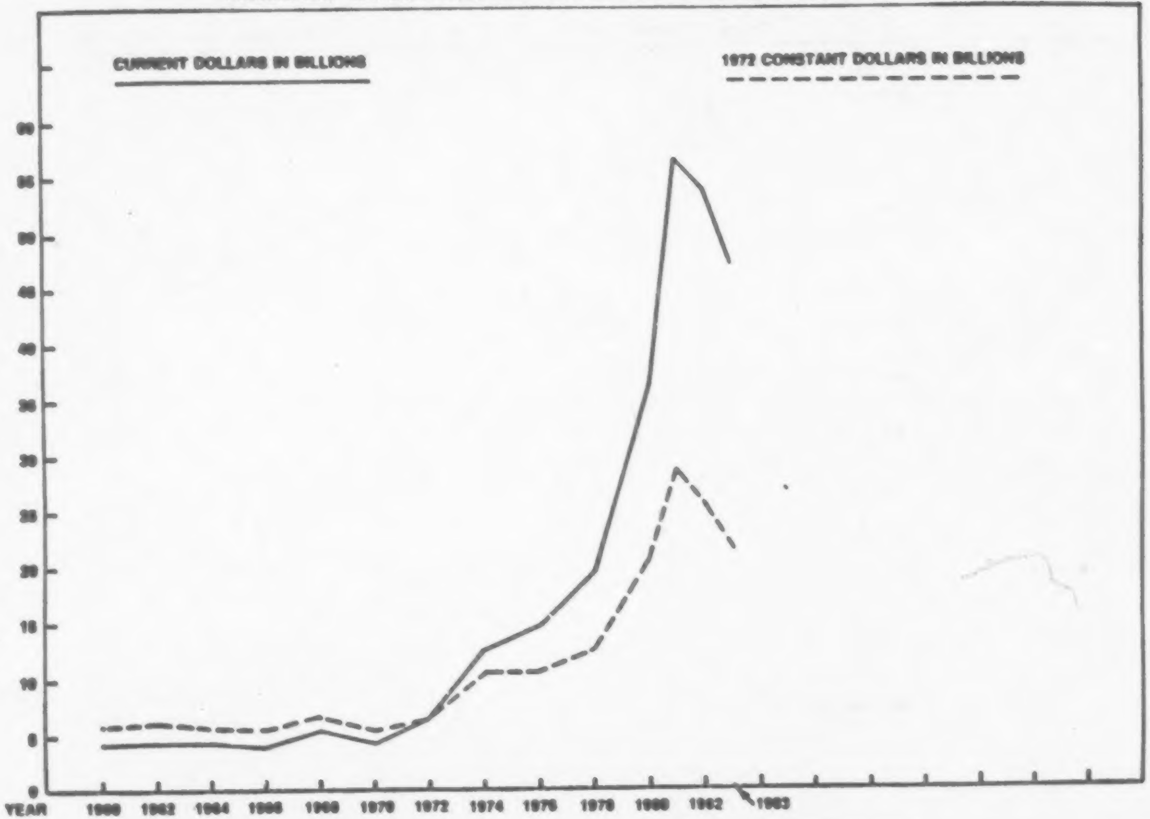
SOURCE: ENERGY INFORMATION ADMINISTRATION, 1982 ANNUAL ENERGY REVIEW, APRIL, 1983.

FIGURE I-8. TOTAL WELLS AND FOOTAGE DRILLED, 1960-1983



SOURCE: ENERGY INFORMATION ADMINISTRATION, 1982 ANNUAL ENERGY REVIEW, April, 1983.

FIGURE I-C. EXPLORATION AND DEVELOPMENT EXPENDITURES, 1960-1983



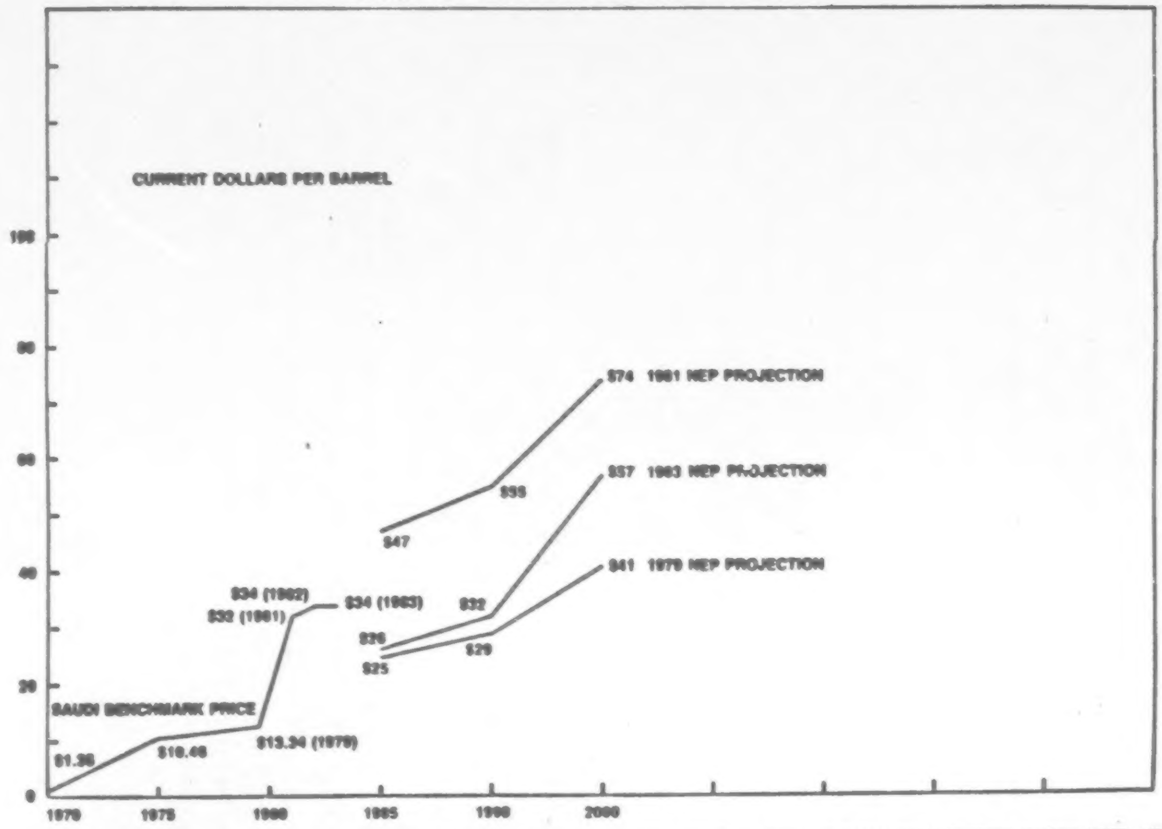
SOURCE: INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA AND ENERGY INFORMATION ADMINISTRATION.

In contrast, total domestic oil decontrol has allowed oil exploration to respond quickly and efficiently to changes in supply and demand. Since total decontrol of crude oil in January 1981, domestic exploration for oil has continued to increase. The number of oil wells drilled increased by 38 percent from 1980 to 1983.

The disparities between oil and gas exploration are continuing in 1984. Preliminary data for the first quarter of 1984 show that total oil wells completed and total oil footage drilled were both up 13 percent compared to the first quarter of 1983. In contrast, gas well completions were down about 3 percent, while total gas footage drilled was down 10 percent.

Because successful exploration today produces a stream of oil or gas production that will continue for many years, industry price expectations play a more important role than current prices in determining exploration activity. The dramatic changes in industry price expectations over the last 5 years are probably more responsible than any other single market factor in explaining the dramatic changes in domestic exploration activity during the past 5 years. Figure I-D shows the oil price projections (in current dollars per barrel) contained in the 1979, 1981, and 1983 National Energy Policy Plans.[1/] Although DOE projections are not necessarily those used by the oil and gas industry, they do reflect extensive consultation with many academic, independent, and industry energy analysts.

FIGURE I-D. HISTORICAL OIL PRICE PROJECTIONS



SOURCE: DEPARTMENT OF ENERGY, ENERGY PROJECTIONS TO THE YEAR 2010, OCTOBER, 1983 and 1982 ANNUAL ENERGY REVIEW, APRIL, 1983.

In 1979, the Saudi benchmark price was $13.34 per barrel. DOE projected that oil prices would increase to $25 per barrel in 1985 and to $41 per barrel in the year 2000. In 1979, 49,820 wells were drilled in the United States.

By 1981, the Saudi benchmark price had increased to $32 per barrel, and DOE projected an oil price of $47 per barrel in 1985 to $74 per barrel in the year 2000. This represents an average annual increase in oil price of 3.1 percent per year between 1985 and the year 2000. Drillers responded dramatically and drilled 78,540 wells in 1981--58 percent more than in 1979.

In 1983, the Saudi benchmark price was $34 per barrel and the DOE midrange projection showed oil prices below the 1981 projections for every year through the year 2000. The 1983 DOE midrange projection was $26 per barrel in 1985 and $57 per barrel in 2000. Exploration activity dropped off, although it remained well above its historical levels. In 1983, 76,330 wells were drilled, 2.8 percent less than in 1981.

In summary, expected future oil and gas wellhead prices play an important role in determining the level of domestic exploration activity. Because the price of domestic oil is largely set by the world price of oil which is primarily determined by the production decisions of the country members of OPEC, domestic oil company mergers will have no effect whatsoever on this important determinant of exploration activity.

37-154 O—84——13

Geological Attractiveness of Undrilled Prospects

The geological attractiveness of undrilled oil and gas prospects also plays an important role in determining the overall level of domestic exploration activity. Considerations that help determine the level of geological attractiveness include the probability that the prospective reservoir exists and contains oil or gas, the volume and depth of the reservoir, the ease with which the hydrocarbons can be produced (permeability), and the surface location of the prospect (onshore or offshore). If the geological characteristics of undrilled prospects are attractive--for example, if the probability of finding large, shallow reservoirs is high--exploration activity will be profitable and will occur at a relatively high level. On the other hand, if most of the attractive prospects have already been drilled, exploration activity will be relatively low.

Because the onshore lower-48 States is a mature petroleum province, the geological attractiveness of undrilled prospects has begun to decline. Future onshore exploration, therefore, will necessarily be confined to those prospects that are less attractive either because the probability of finding a large reservoir is lower or because the drilling costs are higher than prospects that have already been drilled. There is still uncertainty about the characteristics of onshore prospects in the lower-48 States, especially the deep prospects. As more is learned about these prospects, exploration activity will either increase or decrease, depending on the geological attractiveness of these prospects.

There is even more uncertainty about the attractiveness of prospects in Alaska and on the Outer Continental Shelf. Although it is clear that the drilling costs will be higher, the potential of finding very large reservoirs makes exploration attractive.

Oil company mergers will have no effect whatsoever on the geological attractiveness of domestic oil and gas prospects. To the extent that geological characteristics determine domestic exploration activity, that activity will be unaffected by oil company mergers.

Availability of, and Access to, Domestic Prospects

The amount of onshore and offshore Government acreage available for oil and gas exploration, as well as the restrictiveness of any leasing provisions will affect the total level of exploration. Restrictions on federal leasing, including proposed moratorium legislation, will have a strong detrimental effect on exploration activity. Since mergers will not affect the conditions under which Government acreage is made available, they will not affect the total level of exploration activity.

Lease, Seismic, and Drilling Costs

The costs of mineral leases, geophysical (seismic) tests, and drilling play a role in determining the overall level of domestic exploration activity. As these costs rise, exploration becomes less profitable relative to other investments, and domestic exploration will decline unless the cost increases are offset by other factors. Table I-A shows that lease, seismic, and drilling costs all increased between 1977 and 1981 because exploration activity was increasing. The increases in expected future oil and natural gas wellhead prices during that period more than offset the dampening effect of increasing exploration costs.

In fact, the increase in exploration activity caused some of the increase in exploration costs because of the growing demand for mineral leases, seismic exploration crews, drilling rigs, and drilling crews. The increased demand for these personnel and items necessary to the exploration process caused the price of them to rise. Conversely, as exploration began to decline so did the cost of these services and commodities.

EIA composite drilling costs for 1982 and 1983 reflect an overall downward trend from 1981 for all depths and for all well types. The composite estimate of decreasing costs from 1981 to 1982 ranges from a low of about 21 percent for 2,500-foot wells to a high of about 31 percent for 12,500-foot wells; for 1983, the low estimate in decreased costs ranges from about 9 percent for 15,000-foot wells to about 18 percent for wells less than 3,750 feet.[2/]

Lease, seismic, and drilling costs both affect and, to some extent, depend on the level of domestic exploration activity. But because these costs are independent of oil company mergers, mergers will not affect exploration activity by affecting these costs.

Finding Costs

The "finding cost" is a statistic commonly used by industry to evaluate the profitability of exploration activity. It is simply the cost of reserve additions divided by the volume of additions to proven reserves. The finding cost statistic must be used with care because it is usually calculated using reserve and expenditure data from a single year, even if the reserves were discovered as a result of prior year expenditures. The finding cost statistic also must be used with care because different types of reserves have different values depending on their production costs and whether they are oil or natural gas. Nonetheless, the exploration finding cost statistic is a useful summary of the relationship of two important determinants of exploration activity: the geological characteristics of the drilled prospects and the lease, seismic, and drilling costs.

According to one analysis, finding costs for conventional oil and gas reserves quadrupled over the 1975-81 period.[3/] Table I-B shows that the average cost per foot drilled grew steadily, while the total barrels of crude oil and gas added per foot declined. The data show that, as the easily recoverable reserve base dwindles, wells are drilled increasingly deeper. And, as wells are drilled deeper, the cost per foot rises.

The data show that the average exploration and development costs per well grew by about 15 percent per year between 1977 and 1981.

Table I-A

LEASE, SEISMIC, AND DRILLING COSTS

	1977	1978	1979	1980	1981	1982
Exploratory Wells 1/ (thousand)	9.96	10.68	10.48	11.92	15.17	16.48
Total Wells 2/ (thousand)	44.98	47.06	49.82	60.84	78.54	85.80
Seismic Costs Per 3/ Exploratory Well (thousand nominal dollars)	$ 86	$ 96	$116	$157	$186	$182
Drilling Costs Per 4/ Exploratory Well (thousand nominal dollars)	$324	$384	$536	$728	$893	$783
Lease Acquisition 5/ Costs Per Total Wells (thousand nominal dollars)	$ 64	$ 71	$252	$186	$155	$113

1/ Energy Information Administration, 1983 Annual Energy Review, p. 63.

2/ Includes exploratory and development wells and dry holes. 1983 Annual Energy Review, p. 65.

3/ U.S. Department of Commerce, Bureau of the Census, Annual Survey of Oil and Gas, 1982, March 1984, p. 17.

4/ Ibid., drilling and equipping costs.

5/ Ibid., lease and land acquisitions of producing and nonproducing acreage.

Offshore exploration activities, which accelerated during the 1970's, account for a large part of the growth in composite finding costs. The ratio of offshore to onshore cost per well drilled has been about 10 to 1 since the mid-1970's.[4] According to EIA calculations, the ratio of onshore to offshore exploration and development costs for reserves added was 0.77 between 1976 and 1978. Actual costs of reserves added during this period were $4.82 per barrel onshore and $6.30 offshore. Between 1978 and 1980, the ratio of onshore to offshore exploration and development costs declined slightly to 0.76. Actual costs per barrel during this period were $8.76 onshore and $11.50 offshore.

The offshore share of exploration and development expenditures declined from 44 percent during the 1974-76 period to 37 percent during the 1978-80 period. During the same period, the share of offshore reserve-to-total additions declined from 70 percent to 31 percent.[5]

Because oil company mergers will not affect either of the two primary components of exploration finding cost--geological characteristics of drilled prospects, and lease, seismic, and drilling costs--they will not have a significant effect on domestic finding costs. To the extent that oil company mergers increase the technical efficiency of individual firms, mergers would lower slightly the domestic finding cost.

Taxes and Regulations

Regulations and taxes both change the economic incentives for exploration. During the 1970's, price controls set U.S. domestic wellhead price below the world market and thus dampened the response of drilling. Price controls, by

Table I-B

FINDING COSTS

	1977	1978	1979	1980	1981	1982
Exploration/Development Expenditures (billion current dollars)1/	$17.0	$20.4	$32.9	$40.4	$55.7	$54.0
Reserve Additions2/ (billion barrels oil equivalent)	3.77	3.68	5.07	6.72	7.30	n.a.
Finding Costs Per Barrel (current dollars)3/	$4.51	$5.54	$6.49	$6.01	$7.63	n.a.
Total Footage4/ Drilled (million feet)	211	227	239	285	361	396
Total Wells5/ drilled (thousands)	44.98	47.06	49.82	60.84	78.54	85.80
Exploration/Development costs per well6/	$378	$433	$660	$664	$709	$629
Barrels Added per foot drilled 7/	17.9	16.2	21.2	23.6	20.2	n.a.

1/ Energy Information Administration, 1983 Annual Energy Review, p. 69.
2/ Same as footnote 1.
3/ Finding costs per barrel derived by dividing exploration and development expenditures by reserve additions.
4/ 1983 Annual Energy Review, p. 65
5/ Same as footnote 4.
6/ Expenditures divided by total wells drilled to estimate costs per well.
7/ Reserve additions divided by total footage drilled.

encouraging crude oil imports, also dampened development and production from U.S. wells. Total petroleum imports increased from 6.2 million barrels per day in 1973 to as much as 8.5 million barrels per day in 1979. With full price decontrol of crude oil in 1981, total oil wells completed increased 39 percent from the previous year.

Another Federal regulation, the Windfall Profit Tax introduced in 1981, was designed to capture the "windfall" between market prices for oil and the previously controlled price level. Although there is no aggregate estimate of how much exploration activities are reduced by this tax, we have observed that the tax distorts the economic relationship of drilling responses to higher wellhead prices.[6/]

Recent Congressional regulatory proposals intended to limit the ability of the oil companies to merge are likely to have an adverse effect on domestic exploration and development activities because they would distort market signals and change economic incentives.

Interest Rates

The last factor that affects the aggregate level of domestic exploration activity is interest rates. Because oil and gas exploration is an activity in which capital expenditures are made today (lease, seismic, and drilling costs) in the expectation of production revenues for many years to come, the profitability of exploration heavily depends upon interest rates. As interest rates rise, exploration becomes relatively less attractive as compared to other investments that have a shorter payback period. As interest rates fall, exploration becomes relatively more attractive.

Oil company mergers will not have any noticeable effect on interest rates because they are financial transactions, not an investment or disinvestment in physical assets. Every hour of every day there are vast numbers of similar transactions in oil and gas assets, through farmouts, reserve sales, working interest purchases, and the like. The magnitude of these transactions as companies rearrange their reserve and exploration positions dwarfs recent mergers. Federal Reserve Board Vice Chairman Preston Martin has said,

> These oil takeovers do not harm U.S. credit markets despite the large funds involved.... Such takeover activity can result in a great shift of funds for around 7 to 10 days but the money involved does not go into a black hole.[7]

An analysis by First Boston concluded that each percentage point change in interest rates altered the value of oil property by about 10 percent. For example, lower interest rates in 1983 offset the decline in value attributable to lower world oil prices.[8]

Each of the determinants of exploration activity discussed thus far affect the total level of domestic exploration activity. The remaining factors to be discussed -- a company's cost of funds and the company's capacity to absorb risk -- affect the exploration decisions of specific oil and gas companies but do not affect the total level of exploration.

In the U. S., there is a very active market for buying and selling mineral leases. Oil companies quickly sell a lease if they do not plan to drill on it, and if the lease grants drilling rights to a promising exploration prospect, other oil companies will bid aggressively for that lease. This market for exploration prospects ensures that a decision by an individual firm not to drill a specific well does not necessarily mean that the well will not be drilled.

Both a company's cost of funds and its capacity to absorb risk are often affected by an oil company merger, and these factors must be examined to determine whether a recently merged company will engage in more or less exploration than its constituent parts would have if they had not merged.

Firm's Cost of Funds

The cost of capital to an individual firm is based on the risk-free rate of interest plus adjustments to reflect the firm's credit worthiness. The cost of capital will vary across firms according to many factors internal to the firm, with some firms facing higher borrowing costs than others. The debt-equity structure of the firm is one of the most important factors affecting the rate that a firm would be charged for borrowed capital. For small, highly leveraged firms, cash flow considerations also affect the decision to invest capital in a project and the cost of borrowing that capital. Thus, differential capital costs affect the value of exploration for a specific firm.

Large energy mergers typically involve the issue of long-term debt and equity in order to fully finance the costs of the acquisition. In recent years, U.S. Steel issued long-term notes of $2.2 billion and incurred a bank debt of $3 billion in their acquisition of Marathon Oil, while DuPont increased long-term borrowings by $3.9 billion and issued common stock for $3.8 billion in their acquisition of Conoco. Merger-related financing generally results in a noticeable increase in the acquiring firm's debt-equity ratio. However, the acquiring company typically sells assets and takes other measures in order to reduce their long-term debt. For example, DuPont sold certain Conoco oil and gas properties for $775 million in 1983 and Occidental Petroleum reports sales of Cities Service assets in 1983 worth $1.5 billion. Thus, although large energy mergers may result in increased debt-equity ratios, the acquiring firms tend to adjust their asset deployment to mitigate the adverse effects on their cost of capital. If mergers have any impact at all on long-term investments, such as exploration and development activities, it is likely to affect the timing of the firm's investment, rather than whether or not the firm decides to make the investment.

Capacity to Absorb Risk

A firm's capacity to absorb risk is determined by its ability to survive different financial outcomes. For example, a small firm may be less willing to commit its assets than a larger, well-capitalized firm. Even if an investment has a high expected monetary value, the small investor might be unwilling to risk short-term cash flow problems from a capital expenditure. As a result, large and small firms may require different internal rates of return for the same capital investment, because of differences in their asset structure. Some modification to the strictly financial cash flow equation is therefore necessary to incorporate the risk factor.

If an oil company merger significantly increases the company's internal capital base, it may increase the willingness of the firm to take on greater risks. This is because the firm may have a greater ability to survive larger adverse outcomes, such as a dry hole in a region with high drilling cost.

The Effect of Five Recent Mergers on Exploration

As described in detail in the preceding section, the net effect of an oil company merger on the exploration activity of the parties to the merger can only be determined on a case-by-case basis. Newly formed firms will sometimes explore more than their predecessors, sometimes less. It is significant, though, that the exploration budgets of the oil companies that merged or were acquired during 1979 through 1982 followed a pattern very similar to the rest of the industry. Specifically, for those three mergers that took place during 1979 through 1981, the exploration budget of the merged firm was substantially higher than the sum of the exploration budgets prior to the merger. During that same period, total industry expenditures on exploration were increasing.

For those two mergers that took place in 1982, the new exploration budget was lower than the sum of the previous year budgets. In 1982, total exploration expenditures were also slightly lower than in 1981.

Table I-C shows the lease acquisition, exploration and development budgets for the five oil companies that merged or were acquired during 1979 through 1982. Also shown for comparison are the total industry expenditures for lease acquisition, exploration and development. Between 1978 and 1981, total industry expenditures rose at an annual rate of 40 percent, from $20.4 billion to an estimated $55.7 billion. Between 1979 and 1981, exploration expenditures for the companies which merged grew at an annual average rate of 27, 31, and 40 percent. Total industry expenditures declined in 1982 by about 4 percent from the 1981 level. The two companies which merged in 1982 spent 14 percent and 50 percent less than they did in the year prior to the merger.

In summary, the exploration budgeting decisions of the five recently merged firms are not significantly different from exploration budgeting decisions of the entire domestic industry. Mergers do not affect exploration decisions; factors described earlier in this report determine exploration activity levels for all firms, regardless of whether they have recently merged with or acquired another company.

Other Published Studies

Although they did not specifically address the issue of oil company mergers, three recently published empirical studies support the conclusion that mergers will not affect the overall level of domestic exploration activity. Each study is based on a formal model of domestic exploration that explicitly describes the determinants of exploration activity. In each case, the determinants are those which would not be affected by oil company mergers.9/ 10/

Table I-C

DOMESTIC EXPLORATION AND DEVELOPMENT EXPENDITURES BY MERGED FIRMS1/

(in millions of dollars)

Name of Firm	YEAR 1978	1979	1980	1981	1982	1983	Year Firm Merged
Conoco	337	473	632	--	--	--	
DUPONT	--	--	--	--	--	--	
Merged	--	--	--	932	812	680	1981
Cities Service	360	419	604	795	--	--	
OCCIDENTAL	68	96	210	187	--	--	
Merged	--	--	--	--	491	379	1982
Marathon	198	306	436	545	--	--	
U.S. STEEL	--	--	--	--	--	--	
Merged	--	--	--	--	470	460	1982
Belridge	33	--	--	--	--	--	
SHELL OIL	1,146	--	--	--	--	--	
Merged	--	1,467	2,074	2,647	2,405	2,067	1979
Texas Pacific	112	125	--	--	--	--	
SUN OIL	361	419	--	--	--	--	
Merged	--	--	916	958	1,034	808	1980
TOTAL INDUSTRY EXPENDITURES2/	20,400	32,900	40,400	55,700	53,700	N/A	

1/ From company annual reports; excludes expenditures for proven acreage in the year of the merger, includes acquisition of properties, exploratory and development costs.

2/ 1983 Annual Energy Review, p. 69.

Many models are concerned with drilling within particular fields or on selected geographical regions as opposed to total industry drilling. While all three models account for the underlying economic conditions, two of them (Harbaugh and Pindyck) have little predictive value for estimating how changes in one variable might affect the overall profitability of drilling.

The most recent empirical analysis of the determinants of petroleum exploration from the American Petroleum Institute attempts to measure the change in key variables and the expected effect of this change on drilling.[11] The model is a cash flow analysis incorporating oil price expectations, but it goes further than the two other models examined by including such variables as the Windfall Profit Tax and price controls. The model distinguishes between onshore and offshore well completions. For example, for onshore well completions the significant findings of this analysis were the following:

- A 1-percent crude oil price increase leads to a 0.4 percent increase in onshore well completions in the same year
- A 1-percent increase in drilling costs reduces well completions by 0.5 percent
- A 1-percent change in price expectations will produce a proportionate change in the number of onshore wells drilled

- A percentage point change in real interest rates translates into a decline of about 200 onshore wells drilled

Conclusions

The foregoing analysis of the interactions of economic variables and exploration and development activity demonstrates that the petroleum industry is dynamic, expanding and contracting with the major market influences discussed in this section. Historical data reveal a high correlation between aggregate domestic exploration and development and such factors as oil and gas prices, the geological attractiveness of undrilled prospects, drilling, lease and seismic costs, finding costs, and interest rates. These market factors determine the level of domestic oil and gas resource development because they affect the economic incentives facing the petroleum industry as a whole. Because these market factors are beyond the control of individual oil firms, all of the petroleum industry faces the same opportunity costs for investments. Mergers can, therefore, have no effect on the factors that determine aggregate exploration activity in the United States.

For an individual oil firm, however, the decision to invest in exploration and development will not depend solely upon the factors that affect exploration activity for the entire petroleum industry. In addition, the firm must weigh factors that will determine whether exploration will yield an acceptable profit relative to other investment opportunities. The factors which are specific to the firm (cost of funds, capacity to absorb risk, and alternative investment opportunities) affect its decision to engage in exploration and development activities when all other market incentives are right. To the extent that mergers change the assets and liabilities of the merging firms, they may have some effect on the level of exploration and development. In some cases, the merging firm may be so highly financially leveraged in the short term that its cost of capital rises. On the other hand, the new firm could be in a stronger financial position, if the merger results in a more efficient corporation. Thus, the effects of mergers on exploration activity by individual firms must be evaluated on a case-by-case basis.

In any case, there is a very active market for undrilled oil and gas prospects. If a merger reduces the expected value of exploration for an individual firm, the firm will either sell its prospect or delay drilling until its lease expires. In either case, some firm will buy the prospect and drill when exploration and development are profitable. Thus, even in this hypothetical case, any adverse effect of a merger would be temporary.

PART II

COMPETITION IN THE PETROLEUM INDUSTRY

Introduction

This part of the report addresses the effect of oil company mergers on competition in the petroleum industry. First, recent data on bidding for leases on the Outer Continental Shelf (OCS) will be examined. This data should illustrate the degree of competition in a key area of the exploration and development sector of the oil industry. Next, a widely accepted theoretical approach to industry concentration analysis will be presented, along with current empirical evidence for the domestic petroleum industry. This analysis will yield an evaluation of competition in the oil industry relative to the data and the effects of the proposed mergers on competition. It is important to remember that the Federal Trade Commission has ample authority to review and analyze the effect on competition of mergers among major oil companies.

This analysis focuses on the domestic activities of U.S. oil companies. Many of these firms are also active abroad and all U.S. firms must compete with foreign suppliers. The extensive trade in petroleum helps ensure competition in the U.S. oil industry. In particular, domestic oil prices are set by the world oil prices which are primarily determined by the production decisions of OPEC countries.

Outer Continental Shelf Development

The Outer Continental Shelf leasing programs contribute significantly to the Nation's oil and gas supply. Through the end of 1983, U.S. Federal offshore land has produced more than 6.3 billion barrels of oil and 62 trillion cubic feet of gas. It is estimated that an additional 43.5 billion barrels of oil and 230.6 trillion cubic feet of gas remain in Federal offshore land. During 1982, offshore oil and gas production represented about 10 percent of total domestic oil production and 25 percent of domestic natural gas production.

Bidding for leases is a very competitive process, involving numerous firms, and with an especially high degree of participation by the top 26 major oil companies. The high participation by these major companies may be attributed to the high risk and costs associated with developing OCS leases, particularly in the Alaska offshore areas. Among the major companies, expenditures in developing and producing OCS leases grew by almost 30 percent between 1974 and 1980. In 1981, these major companies acquired 75 percent of all OCS acreage awarded and bid a total of $9.7 billion for these tracts. This sum represents 71 percent of the total amount of bids submitted to Federal OCS lease sales in 1981.

Recent data clearly indicate that OCS bidding is highly competitive. In the Gulf of Mexico, 78 companies bid on more than 650 offshore tracts in May 1983 (see Table II-A). In August 1983, 78 companies bid on 436 tracts; and in January

1984, 20 companies bid on 156 tracts. These figures show broad participation in bidding for available tracts. In the Alaska offshore leases, there were 23 companies bidding for 125 tracts in October 1982, 12 companies bidding for 64 tracts in March 1983, and 19 companies bidding for 97 tracts in April 1983.

Some individuals have expressed concern that mergers will reduce competition among firms engaged in bidding and will therefore retard the development and exploration of offshore oil and gas resources. Our data indicate that the market for OCS tracts is highly competitive. Recent bidding patterns demonstrate that many firms are in the market for OCS tracts through both solo and joint bids (see Table II-B). As the analysis on concentration will show, the oil industry is not very concentrated compared to other major U.S. industries.

Even after the mergers proposed for 1984 occur, the industry will not be highly concentrated, and strong competition among firms for OCS leases will continue. Further, many more firms are able to compete in the market for offshore tracts by bidding jointly with other companies. The data indicate that many more bids--even by major oil companies--are offered jointly than alone. Joint bidding permits more firms to compete for and acquire OCS tracts by increasing the total amount of money offered through pooled capital funds. Thus, joint bidding broadens the participation in OCS bidding to include many smaller, independent firms. The proposed mergers would not change the observed pattern of bidding since so many joint ventures by the major companies already exist. For example, in January 1984, Shell Oil won 15 solo bids in the Gulf of Mexico, but won 19 joint bids in the same area. Conoco

Table II-A

OCS LEASE SALES, GULF OF MEXICO AND ALASKA, 1982-84

Date of Sale	No. of Bids	No. of Companies Bidding	No. of Tracts Available	No. of Tracts Bid On	Acreage Leased	Dollar Amount of Accepted Bids
Gulf of Mexico						
January 1984	226	20	8,866	156	897,785	310,586,261
August 1983	773	78	5,848	436	2,256,073	1,504,692,517
May 1983	1,015	78	7,050	656	3,089,811	3,367,606,134
Alaska						
April 1983	150	19	479	97	546,546	426,458,830
March 1983	98	12	418	64	335,898	317,873,372
October 1982	252	23	338	125	662,861	2,055,632,336

Source: Department of the Interior, Minerals Management Service, April 1984.

Table II-B

BIDDING OF MAJOR OIL COMPANIES ON OCS LEASES
(Gulf of Mexico, January 1984)

Name of Company	Number of Winning Solo Bids	Number of Winning Joint Bids with Other Major	Number of Different Majors with Winning Joint Bids Tendered
Amerada Hess	-	-	4
Amoco	-	19	-
Arco	3	-	-
Chevron	4	1	6
Conoco	10	14	6
Exxon	2	10	-
Getty	-	16	-
Gulf	-	18	12
Kerr-McGee	-	-	3
Marathon	-	-	5
Mobil	-	-	6
Shell	15	19	-
Sohio	13	-	2
Superior	11	14	12
Tenneco	2	4	15
Texaco	3	3	3
Union	2	3	3

Source: Wall Street Journal, January 6, 1984, p. 26.

won 10 solo bids in the Gulf that same month but also won 14 joint bids. Similar data are available for other major oil company bids. Finally, the U.S. Department of the Interior, which reviews OCS bids on a case-by-case basis, has the authority to reject any bid if there is evidence of anticompetitive behavior on the part of the firm or firms involved in the bid. For these reasons, oil company mergers are not likely to reduce competition in the market for offshore leases or retard the development of OCS resources.

Competition and Mergers

Traditional concentration analysis shows that the petroleum industry is less concentrated and more competitive than many other major domestic industries. For example, in 1977 at least 59 percent of U.S. manufacturing industries had a four-firm concentration ratio that was higher than the four-firm concentration ratio for crude oil production. More recent data for other industries are not available. As described in more detail in the next section, the concentration ratio levels for crude oil production increased from the 1950's until 1970, but generally have decreased since then. Mergers will add little to the overall concentration of crude oil production.

It must be recognized that even if concentration in the producing sector of the domestic oil industry were to increase dramatically, in all likelihood there would be no effect on domestic oil prices. Domestic oil prices are set by the world price of oil which is primarily determined by the production decisions of the country members of OPEC.

Concentration

Concentration indexes provide some indication of the level of competition that can be expected in an industry. The concentration concept takes into account both the number of firms and their size dispersion. The concentration index used in this report is the "concentration ratio," which measures the ratio of production or sales of a predetermined number of firms (usually four or eight) to the total industry output or sales. This index has been used most frequently in studies of competition.

Since many economists consider the Herfindahl-Hirschman (H) index to be more defensible in theory than the concentration index, we reviewed the H index for petroleum and found that the petroleum industry is competitive relative to other major U.S. industries. The H index is comprehensive in that it includes both the number and the size dispersion of all firms in the industry. The H index is calculated by expressing each firm's market share as a percentage, squaring it, and summing it for all firms in the industry. If there is only one firm in the market, the H index equals 10,000; if there are many firms of similar size, then H approaches zero.

Economists argue that where entry (or expansion) is unrestricted, the competitive process is likely to be effective regardless of the level of concentration. Conversely, where entry is restricted, the competitive process is less likely to be effective in allocating resources regardless of the level of concentration. This emphasizes the importance that economists place on entry barriers in the analysis of competition. Given particular entry conditions, however, the view that higher concentration is inversely related to the competitive process is firmly rooted in the industrial organization literature. In this section, it is assumed that entry barriers have not changed during the study period. As a result, one may say that a trend to significantly higher or lower concentration over time, ceteris paribus, suggests a decrease or increase in competition.

Concentration Trends: Crude Oil Production 1955-82

This section discusses concentration trends in domestic crude oil production (see Table II-C).

The concentration ratio measures for all three groups were lowest in 1955. The four-firm concentration ratio (CR4) began at 18.1, peaked at 26.3 in 1970, and declined slowly to 24.8 in 1981, rising slightly to 25.1 in 1982. The CR8 began at 30.3, peaked at 41.7 in 1970, and declined fairly steadily to 39.1 in 1982.

These concentration ratios are substantially below the average concentration ratios for manufacturing industries. (See Table II-D for a comparison of petroleum production concentration with other manufacturing industries.) For example, for 292 manufacturing industries in 1958, the unweighted average CR4 was 39.2, and the unweighted average CR8 was 51.6.[12/] For crude oil production, the CR4 and CR8 were 20.8 and 33.5, respectively, in 1960. Thus, the average CR4 for the manufacturing industry was 88 percent greater and the average CR8 was 54 percent greater than for crude oil production.

Table II-C

TRENDS IN THE CONCENTRATION OF DOMESTIC CRUDE PRODUCTION

Concentration Ratios (Percentage of U.S. Total)	1955	1960	1965	1970	1975	1976	1977	1978	1979	1980	1981	1982
Four Largest	18.1	20.8	23.9	26.3	26.0	25.6	24.4	23.5	23.8	25.3	24.8	25.1
Eight Largest	30.3	33.5	38.5	41.7	41.2	40.6	39.4	40.6	40.2	40.8	39.8	39.1
Sixteen Largest	42.2	45.4	51.6	56.3	56.8	57.4	56.6	58.1	57.2	57.5	56.2	55.5
Total U.S. Production (thousands of barrels per day)	7,578	7,964	9,014	11,297	10,008	9,735	9,863	10,275	10,207	10,161	10,181	10,199

Source: Company Annual and 10K Reports, Energy Information Administration, Monthly Energy Review (various issues), and American Petroleum Institute, Market Shares and Individual Company Data for U.S. Energy Markets (various issues).

Notes: Crude production includes crude oil, lease condensate, and natural gas liquids. Net production is used to calculate individual shares. When both plant and lease natural gas liquids are reported, only the latter are included to avoid possible double counting. The data presented here may differ slightly from the data presented in the API reports because of revisions to the data.

Table II-D

CONCENTRATION IN OTHER INDUSTRIES
(Four, Eight, and Twenty Largest Companies)

	1954			1958			1963			1967			1972			1977		
	4	8	20	4	8	20	4	8	20	4	8	20	4	8	20	4	8	20
Cereal Breakfast Foods (20430)	78	89	98	80	91	98	82	94	99	82	94	99	84	96	99	81	95	99
Synthetic Rubber (28220)	52	79	100	54	75	--	52	73	99	49	70	98	54	73	95	56	78	96
Tires & Inner Tubes (3011-)	--	--	--	71	86	97	72	88	97	71	88	97	73	89	97	71	89	97
Glass Containers (32210)	63	78	92	59	74	93	56	72	92	60	75	94	56	77	98	54	75	98
Hot-Rolled Sheet Steel (33123)	--	--	--	56	78	99	55	76	99	56	75	99	54	77	98	62	84	99
Cold-Rolled Sheet Steel (33127)	--	--	--	46	72	98	46	73	99	42	69	99	45	72	99	50	77	--
Passenger Cars (37111)	98	99	100	99	--	100	99	--	100	99	--	100	99	--	100	99	99	100
Power & Distribution Transformers (36122)	85	97	99	80	94	99	76	90	98	71	88	98	67	86	97	70	82	96
Petroleum Production[1/]	18	30	--	21	31	--	24	39	--	26	42	--	26	41	--	24	39	--

Source: Concentration Ratios in Manufacturing, (Bureau of the Census, U.S. Department of Commerce, Washington, D.C.; 1981); Table 9.

[1/] Concentration ratios are for 1955, 1960, 1965, 1970, 1975, 1977.

The pattern is similar for 1970 data, although the gap is narrower. The average manufacturing CR4 was 41.2, and the CR8 was 54.2. The corresponding crude oil ratios were 26.3 and 41.7. Thus, in 1970 the average CR4 was 57 percent greater and the average CR8 was 30 percent greater than the corresponding ratios for crude oil production. Another indication of the relative concentration in crude oil production is that in 1977 the CR4 was larger in at least 59 percent of U.S. manufacturing industries.[13] It is apparent, therefore, that while concentration ratios in domestic crude oil production increased substantially between 1955 and 1970, their absolute levels remained far below the average for manufacturing industries.

The H index of concentration displays the same trends as do the ratio measures. The H index increased from 194 in 1955 to 296 in 1970 and 297 in 1975. By 1982, the H index had declined to 262. These indexes are far below the 1000 level, which is considered by the Department of Justice to be moderately concentrated. In short, by any measure, crude oil production is an unconcentrated industry.

Concentration Trends: Domestic Refining Capacity 1950-82

Concentration indexes for refining capacity show a different trend from crude oil production (see Table II-E). For the top 4, 8, and 16 firms, concentration ratios were highest between 1950 and 1970. Implementation of the Entitlements Program in November 1974 provided crude price subsidies for many small refiners and accelerated their entry to the refining market. The small refiner bias resulted in a steady increase in refining capacity throughout the 1970's and was partly responsible for declining concentration.

Table II-E

TRENDS IN THE CONCENTRATION OF DOMESTIC REFINING CAPACITY

Concentration (Percentage of U.S. Total)	1950	1960	1965	1970	1975	1976	1977	1978	1979	1980	1981	1982
Four Largest	34.7	32.0	30.4	32.5	29.9	29.7	31.0	30.9	29.7	29.1	30.5	29.9
Eight Largest	57.9	55.0	54.3	57.5	53.5	52.0	52.7	52.5	50.3	49.3	50.4	49.5
Sixteen Largest	77.9	74.4	76.9	79.7	74.7	73.0	72.5	71.9	70.7	69.1	71.8	70.5
Total U.S. Capacity (thousands of barrels per day)	6,701.8	9,629.7	10,319.2	12,811.0	15,114.6	16,126.1	17,077.5	17,401.2	17,832.4	18,528.6	16,267.9	15,058.6

Source: Company Annual and 10K Reports, Energy Information Administration, Monthly Energy Review (various issues), and American Petroleum Institute, Market Shares and Individual Company Data for U.S. Energy Markets (various issues).

Concentration in refining capacity for the top 16 firms continued to fall during the 1970's. In 1981, total domestic capacity had declined, but concentration in ownership among the top 16 firms increased slightly. The slight increase in concentration is in part attributable to the elimination of the Entitlements Program.

Throughout the period, the concentration ratios in refining capacity were just about average relative to all manufacturing. In 1958, the unweighted average manufacturing CR4 was 39.2, and the CR8 was 51.6. In 1960, the CR4 for refining capacity was 32.0, while the CR8 was 55.0 A similar pattern is also found in 1970. (More recent data for unweighted average manufacturing industry concentration are not available for comparison with the petroleum industry.)

Conclusions

Concentration changes in two segments of the domestic petroleum industry were examined using concentration indexes.

For crude oil production, the concentration indexes indicate that concentration increased slightly during the 1955-82 period. But relative to other industries, this concentration has been modest. Since the 1970's, there has been very little increase in concentration.

The refining segment has been more concentrated than the production segment, but this concentration declined slightly over the data years.

The comparatively low concentration of the petroleum industry indicates that the industry is competitive. Although mergers may increase slightly the concentration among the top four or top eight firms, concentration among the top few firms will remain low relative to other major industries. Even those firms that merge compete vigorously among themselves for higher sales and a larger share of the market. Mergers will not reduce inter-firm competition.

U.S. law and institutions provide effective checks and sanctions to ensure that no firm or small group of firms exercises market power through collusion. A major condition of the recent Federal Trade Commission consent decrees for both the Texaco-Getty and the Socal-Gulf mergers is that the new firms must divest several downstream operations. The divestitures are designed to limit concentration in ownership within specific markets and within geographical regions.

Finally, the world oil market also helps ensure competition in the domestic oil industry. Both crude oil and petroleum products are widely exchanged in international trade. As a result, domestic crude oil prices are set by the world price of crude oil which is primarily determined by the production decisions of the country members of OPEC. Domestic refinery margins are also limited by the ability of foreign refiners to sell into U.S. markets if domestic refiners attempted to charge artificially high prices for their products.

CONCLUSIONS

Oil company mergers, such as those that have taken place recently, are a clear example of the marketplace at work: they demonstrate the ability of business (here, the domestic oil and gas industry) to adjust quickly and efficiently to changing circumstances. Our analysis of exploration and development activities indicates that mergers are unlikely to affect the economics of a decision to drill. Therefore, mergers should not have any adverse effect on U.S. mineral leasing programs, oil and gas exploration, or the Nation's energy supply. In fact, ~~it is~~ more than likely that the newly combined firms would be more effective in exploring for and developing our oil and gas resources. Any legislative initiative to restrict the ability of companies to operate freely in the marketplace could actually be detrimental to the Nation in these areas.

Moreover, data show that the oil industry is less concentrated and more competitive than many other major domestic industries. Existing antitrust laws provide both the Department of Justice and the Federal Trade Commission with ample authority to review and analyze the effect on competition of mergers among major oil companies. Both the Department of Justice and the FTC have statutory authority to enjoin any mergers that would substantially lessen competition and to seek appropriate relief against any existing oil company that is restraining competition. Justice also has authority to sue for recovery of any damages incurred by the Federal Government as a result of violations of the antitrust laws.

For these reasons, we would urge the Congress to withdraw any antimerger legislation, including the moratorium, on the grounds that it would arbitrarily interfere with the operation of the energy markets while adding nothing to the Federal

Government's ability to prevent and remedy any anticompetitive actions that may occur in this industry. As a matter of energy policy, we currently see no reason why energy company mergers should be treated differently from other types of mergers, which frequently can result in a consolidation and strengthening of firms in various sectors of our economy. We are concerned that interference with energy investments would only drive available resources away from the energy sector and thus adversely affect the primary goal of the President's National Energy Policy Plan, which is to ensure that Americans have "an adequate supply of energy at reasonable costs."

FOOTNOTES

1/ U.S. Department of Energy, Energy Projections to the Year 2010 (Washington, D.C.: October 1983).

2/ Energy Information Administration, Indexes and Estimates of Domestic Well Drilling Costs (Washington, D.C.: U.S. Government Printing Office, September 1983).

3/ Thomas A. Petrie, "Recent Petroleum Mergers and Acquisitions: An Analyst's Perspective" (New York: First Boston Research Corporation, March 1983).

4/ Data Resources, Inc., Drilling Model, composite cost estimates for all wells drilled by major U.S. petroleum companies

5/ Energy Information Administration, Energy Company Development Patterns in the Postembargo Era, Vol. 1 (Washington, D.C.: U.S. Government Printing Office, September 1982).

6/ Producers in the Alaska North Slope, for example, are willing to show lower netbacks or wellhead prices since the windfall profit tax takes away about 60 percent of the producer's marginal dollar. Thus producers will seek profits in other areas of petroleum production. In Alaska, for instance, because of the high tax rate on wellhead prices, producers prefer to make their profits on oil shipments rather than on production.

7/ Preston Martin, Federal Reserve Board Vice Chairman, speaking before The National Advisory Council of the Senate Committee on Small Business, March 15, 1984.

8/ Thomas Petrie and Suzanne W. Wright, "Mergers & Acquisition Trends in Energy: A Perspective on Recent Transaction Patterns, Implications for Capital Market and Oil Equities," (New York: First Boston Corporation, March 1984).

9/ Robert S. Pindyck, "Higher Energy Prices and the Supply of Natural Gas," in Energy Systems and Policy, (New York: Crane, Russak & Company, Inc., 1978).

Pindyck describes the behavior and interaction of the natural gas market. The empirical data that fit the equations were updated to 1974. The determinants of exploratory drilling were expected revenues, expected risks, average drilling costs, and interest rates. Exogenous variables were oil and gas price changes, resource depletion, and the size of discoveries per successful well. Pindyck was able to fit his model to past drilling behavior using only these determinants, and was not forced to use any factors that would be affected by oil company mergers such as industry concentration ratios.

10/ John W. Harbaugh, John H. Doveton, and John C. Davis, Probability Methods in Oil Exploration, (New York: John Wiley & Sons, 1977).

This model provides optimal decision analysis using the probability theory as influential to the expected value of exploration against the relevant variables. Exploration decisions are a part of a long train of decisions facing the firm in which a particular choice is but one in a series of related acts. The expected value of exploration to the firm must include the probability of discovering any oil or gas and the financial consequences of the alternative outcomes. The model incorporates the risk in committing the assets and capital of the firm by constructing "utility tables," which describe the risk position of the firm given the expected monetary outcomes of drilling. This model shows that a drilling decision necessarily includes economic and geological information and has as its objective the attainment of optimal choices, given a particular set of financial goals and risk position.

11/ Deborah A. Ott and Donald A. Norman, An Empirical Analysis of the Determinants of Petroleum Drilling (Washington, D.C.: American Petroleum Institute, 1983).

12/ The average concentration ratio data for 1960 and 1970 are from Willard F. Mueller and Larry G. Hamm, "Trends in Industrial Market Concentration, 1947 to 1970," Review of Economics and Statistics, Vol. 56, No. 4, November 1974, (Amsterdam: Elsevier Science Publishers, B.V. North Holland, November 1974, pp. 511-20).

13/ Calculated from data in Bureau of Census, Concentration Ratios in Manufacturing (Washington, D.C.: U.S. Government Printing Office, 1981).

BIBLIOGRAPHY

Bureau of Census, Concentration Ratios in Manufacturing, Washington, D.C., U.S. Government Printing Office, 1981.

Business Week, New York, N.Y., McGraw-Hill Publishers, April 16, 1984.

Energy Information Administration, Energy Company Development Patterns in the Postembargo Era, Vol. I, Washington, D.C., U.S. Government Printing Office, 1982.

Energy Information Administration, Indexes and Estimates of Domestic Well Drilling Costs, 1982 and 1983, Washington, D.C., U.S. Government Printing Office, 1983.

Energy Information Administration, 1982 Annual Energy Review, Washington, D.C., U.S. Government Printing Office, 1983.

Harbaugh, John W., John H. Doveton, and John C. Davis, Probability Methods in Oil Exploration, New York, John Wiley & Sons, 1977.

Ott, Deborah A. and Donald A. Norman, An Empirical Analysis of the Determinants of Petroleum Drilling, Washington, D. C., American Petroleum Institute, 1983.

Petrie, Thomas A., "Recent Petroleum Mergers and Acquisitions: An Analyst's Perspective," New York, First Boston Corporation, 1983.

Petrie, Thomas A. and Suzanne W. Wright, "Mergers & Acquisition Trends in Energy: A Perspective on Recent Transaction Patterns, Implications for Capital Market and Oil Equities," New York, First Boston Corporation, March 1984.

Pindyck, Robert S., "Higher Energy Prices and the Supply of Natural Gas," Energy Systems and Policy, New York, Crane, Russak & Company, Inc., 1978.

Preston, Martin, Speech before the National Advisory Council of the Senate Committee on Small Business, March 15, 1984.

U. S. Department of Energy, Energy Projections to the Year 2010 Washington, D.C., U.S. Government Printing Office, 1983.

Senator **Warner**. Thank you, Senator Hecht.

Thank you very much, gentlemen. We will now proceed with the second panel consisting of Mr. Ken T. Derr, president, Chevron, U.S.A.; Mr. James L. Murdy, executive vice president, Gulf Corp.

STATEMENT OF KENNETH T. DERR, PRESIDENT, CHEVRON, U.S.A. INC., AND VICE PRESIDENT AND DIRECTOR, STANDARD OIL CO. OF CALIFORNIA

Mr. **Derr**. Thank you, Mr. Chairman. My name is Kenneth Derr. I am a vice president and director of Standard Oil Co. of California and president of Chevron U.S.A. Chevron U.S.A. is responsible for all of Socal's oil and gas operations in the United States.

I submitted a prepared statement and request that it be made a part of the record. That statement discusses a number of aspects of the Socal-Gulf merger as well as why we believe in general mergers of this type are in the Nation's interest. In my oral statement this morning, I would like to focus on three aspects of the merger that I think may be of particular interest to this committee.

The first is what effect the merger will have on our exploration programs. Some people have said we will be cutting back on exploration because we have drilled on Wall Street. Others have said we will be paying so much money in interest that we will not have enough left to spend on exploration. Neither statement is true.

We view the reserves that we will acquire in our merger with Gulf strictly as an addition to our normal effort to add to our reserves by exploration. They are a valuable asset that we were able to acquire for our shareholders at an attractive price.

Our company will continue to place a very high priority on exploration in the future. We believe this merger will bring together the exploration resources of our two companies in a new combination that will be stronger than the sum of its parts. Mr. George Keller, chairman of Standard of California, has already testified in several hearings that we plan to carry on an exploration program after the merger that will be comparable in effort to the combined programs the two companies would have carried on individually.

In addition, we sincerely hope the program will become even more effective because of the stimulating effects of combining our technical and research organizations. We also expect to have adequate money to fund such an exploration program. Gulf's earnings last year were $978 million. Although our interest costs initially will be at a rate in excess of $600 million a year after tax, most of this amount will be offset by savings of almost $500 million from not having to pay dividends to Gulf shareholders after the merger.

Thus, it is clear that we expect the Gulf operations to generate adequate funds to carry its full share of the combined exploration program I referred to above. The second aspect of the merger that I would like to comment on is its effect on competition and I will be brief here, because you have heard quite a bit on this subject already.

Our industry is well known for its absence of economic concentration. After the Socal-Gulf merger, the combined companies will represent about 7 percent of U.S. oil production, 14 percent of U.S.

refinery capacity, and about 11 percent of product sales. These are hardly numbers to cause concern.

And the latter two percentages will undoubtedly be smaller if it seems likely the FTC requires us to divest some of Gulf's refining and marketing operations.

The oil industry, every aspect of it, from drilling to marketing have many thousands of very small companies involved. There is no indication that this will change.

Third, I would like to comment in general why we feel you are seeing an unusually large number of oil company mergers these days. One reason is the increasing difficulty and cost of finding new reserves of oil and gas. This has been brought about chiefly by two constraints. One, geology, and, two, Government policies.

With respect to geology, members of this committee are no doubt aware that the onshore continental United States has been pretty extensively prospective. While many more worthwhile reserves of oil and gas will be found onshore and offshore in the United States, it seems likely that most large oil and gas fields will be found in higher risk, higher cost frontier areas.

But even in these areas recent exploratory results have been somewhat disappointing as the recent dry hole at Mukluk on Alaska's north slope showed. So the oil industry is finding fewer good prospects in the United States today. With respect to Government policies, you are also aware that the Federal Government and to some extent other levels of government have withdrawn large areas of Government land from potential exploration.

This puts off limits some of the more promising areas our industry was counting on to discover more oil and gas. As an example, about 85 percent of the California coast line is now off limits to exploration because of various moratoria proposals. In addition, Government is also responsible for the so-called windfall profits tax, which takes billions of dollars each year out of pool capital that might otherwise be available for oil and gas exploration and development.

Socal and Gulf's total windfall profit tax payments during the last 3 years totaled $4.7 billion. As a comparison Socal and Gulf's total expenditures for exploration in that same period totaled $5.9 billion.

Another reason for oil company mergers is that the price of most oil company shares is depressed compared with the value of their underlying assets. This depression of stock prices is caused by several reasons. First, oil company earnings have dropped dramatically in the last few years. Socal's 1983 earnings were more than a third below that of 1980.

And our return on equity as well as the oil industry's overall average return has dropped by 50 percent. Second, most Government and industry economists believe the demand for oil will increase only very gradually for many years. In fact, we predict U.S. oil demand to increase less than 1 percent per year through the year 2000.

Third, as this committee knows, there is a very large surplus of oil producing capacity around the world today. This surplus is forecast to continue for many years. And, finally, there is a great deal of excess refining and marketing capacity, which must be consolidated if consumers are to be served efficiently.

Petroleum demand today is 20 percent lower in the United States than it was in 1978. This country still has a good deal of excess refining and marketing capacity that was built to meet the Nation's needs at that time that won't be needed again. Some of this excess capacity has already been shut down and more will be shut down in the future.

Mergers in the industry are an efficient way to bring about the restructuring and consolidation of the oil industry that is both desirable and inevitable. Eventually this will result in a U.S. refining and marketing industry that is efficient and viable to serve the needs of the American consumer.

In summary, I clearly believe that oil industry mergers do not create any significant problems to the country provided they comply with existing antitrust laws and, finally, that the specific Socal/Gulf merger is very much in the best interest of all parties involved and the Nation as a whole.

Thank you very much.

Senator WARNER. Thank you.

[The prepared statement of Mr. Derr follows:]

WRITTEN SUBMISSION OF MR. KENNETH T. DERR

PRESIDENT, CHEVRON U.S.A. INC.

before the

SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES

of the

ENERGY AND NATURAL RESOURCES COMMITTEE

of the

UNITED STATES SENATE

APRIL 10, 1984

My name is Kenneth T. Derr. I am a Vice-President and Director of Standard Oil Company of California, and President of Chevron U.S.A. Inc. Chevron U.S.A. Inc. is a wholly-owned subsidiary of Standard Oil Company of California which is responsible for the company's oil and gas operations in the U.S. I am here to provide any information I can about oil industry mergers and the merger of Standard Oil Company of California and Gulf Corporation.

I appreciate the opportunity to appear today and to discuss what I understand are some of the subcommittee's concerns.

I believe we can show that the merger of Standard Oil Company of California and Gulf Corporation is an excellent merger and that it will benefit the nation as well as the parties involved. My reasons are as follows:

- The merger will bring together the exploration and producing resources of our two companies in a new combination that we believe will be stronger than the sum of its parts. We believe it will result in a more effective exploratory program, both in the United States and abroad. I would particularly like to bring to the attention of the committee that after the merger we plan to carry on an exploratory program that will be comparable in effort to the total of the programs our two companies would have carried forward individually. However, we hope the program will be even more effective because of the stimulating effects of combining our technical and research organizations. I might say too that we are confident that we will have enough money to carry out a program of this size.

- The merger will provide for a reorientation of Gulf's refining and marketing operations in a way that offers the best opportunity to preserve their viability as going businesses. It will also conform to all government requirements.

- The merger will preserve more jobs than any other realistic alternative.

- The merger will preserve the competitiveness of the existing industry structure. The oil industry is widely known for its absence of economic concentration. This will not be significantly affected by the merger.

- The merger will not significantly affect either the cost or the availability of credit.

- The merger will not have an adverse effect on taxes paid to the U.S. Treasury.

We believe that mergers are in the national interest provided they meet the test of antitrust limitations required by existing legislation. New laws prohibiting or delaying mergers that do not adversely affect competition would be a serious mistake.

As Assistant Attorney General, J. Paul McGrath, said in a recent speech,

> "Government merger policy strongly affects the economy. The free movement of business assets is critical to economic growth. For that reason, business managers must be free from irrational antitrust constraints in deciding whether to acquire or divest businesses. Antitrust enforcers should only block mergers when they conclude, based on sound economic analysis, that a particular transaction will adversely affect competition."

You are aware that the FTC is studying the merger to see if there are any adverse competitive consequences. We filed our Hart-Scott-Rodino pre-merger notification on March 8. The FTC has asked us for additional information, and we have met their requests. We will do whatever may reasonably be required to meet any antitrust concerns.

I am here today to provide any information I can on the merger. I do not, however, consider myself an authority on mergers other companies have made or may make in the future. I plan, therefore, to confine my remarks to the facts surrounding our merger with Gulf, and to the conditions in the petroleum industry that I believe make such mergers desirable.

I would like today to testify on four subjects:

- o Why conditions in the oil industry make mergers desirable.
- o Why Socal merged with Gulf.
- o How Socal plans to implement the merger.
- o Effects of the merger on various groups and on the national interest.

Why Conditions in the Oil Industry Make Mergers Desirable

Most economists believe that mergers are a normal and healthy part of our free economy. Through mergers, companies can become more efficient, thus benefiting the consumer. Mergers are a part of the process of reassessing the nation's resources of capital and manpower and redeploying them to the most productive uses in our changing economy. This process is not without risk to the managements of the companies involved. Recent events in the oil and other industries show that even the managements of very large companies - probably including our own - are not immune to this process. However, I believe this represents a healthy process of competition and renewal which the Congress should encourage.

A number of recent mergers have involved oil companies. I believe this is a desirable trend. There are two basic conditions that have brought this about.

The first is the increasing difficulty and cost of finding oil. Our company used to feel that we could find and develop oil and gas reserves more cheaply than we could buy them. We are not sure that is true today, particularly in the United States. We have in our company what I believe is one of the most efficient and successful exploration organizations in the oil business. Nevertheless, our oil and gas reserves have been gradually declining. The difficulty and cost of finding oil have increased rapidly in recent years for several reasons.

o First, the onshore continental U.S. has been pretty extensively prospected. While many more worthwhile reserves of oil and gas will be found onshore and offshore in the U.S., it seems likely that most large oil and gas fields will be found in higher-risk, higher-cost frontier areas. But even in these areas, recent exploratory results have been disappointing, as the dry hole at Mukluk on Alaska's North Slope showed. So the oil industry is finding fewer good prospects for discovering new oil reserves in the United States today.

- Second, actions by the United States government - and, to some extent, other levels of government - have withdrawn large areas of government land from exploration. As an example, some 85% of the California coastline is now off limits to oil and gas exploration because of moratoria. Thus government has put off limits some of the more promising areas where the industry was expecting to discover more oil and gas. We believe government restrictions play an important role in reducing the number of prospects available in the U.S. today.

  Government is also responsible for the so-called "windfall profits tax," which takes billions of dollars each year out of the pool of capital that would otherwise be available for oil and gas explorations and development. As a matter

> of interest, Socal's and Gulf's total windfall profits tax payments during the last three years amounted to $4.7 billion. Socal's and Gulf's total expenditures for exploration during this same period were $5.9 billion.

These factors, combined with the belief that oil prices in real dollars are not likely to increase for many years, have led to a decline in the number of active rigs in the United States from over 4,500 in 1981 to under 2,500 today.

Nevertheless, our company is continuing to carry forward a very large exploratory program. We currently have active exploration operations in 21 states and 38 foreign countries. And as I said earlier, we plan after the merger to conduct a major exploratory program.

At this point, I would like to put to rest the concern of those who see this merger as merely "drilling for oil on Wall Street." It is far from that. We are enormously proud of our company's technical capability and track record as a leader in exploration for oil and gas, and in the research that supports this program.

This capability, combined with the resources of Gulf and the financial strength of the merged operations, will be applied to

Gulf's extensive reserves and landholdings. As a result, we will be able to carry out an outstanding exploration program that will combine the resources of both companies. I believe consumers and the nation are well served when a merger of this kind results not only in the acquisition of reserves, but also in a more effective exploratory program than the two companies would have had on their own.

Beyond what we can accomplish by our own strong exploratory program, we are constantly looking for opportunities to add to our oil and gas reserves in other ways.

This brings me to the second reason why a number of oil company mergers have taken place in recent years. That is, the depressed price of the common stock of many oil companies. These shares are depressed for several reasons:

- First, most government and industry economists believe that demand for oil in the U.S. will increase only very gradually for many years.

- Second, there is a very large surplus of oil producing capacity around the world today.

- And finally, there is a great deal of excess refining and marketing capacity which must be consolidated if consumers are to be served efficiently.

The chart attached to this statement (Attachment 1) shows why there is so much excess refining and marketing capacity in the U.S. today. It shows demand for petroleum products in the U.S. since 1950 and our estimate for the future. The different bands show the major types of products.

As you can see, demand for petroleum products in the United States rose almost continuously from 1950 until 1978. Since then, it has declined sharply from a peak of almost 19 million barrels per day to about 15 million barrels per day in 1983. This is a drop of almost 20%. The decline was caused by the consumers' response to the large petroleum price increases triggered by the Arab Oil Embargo and the Iranian Revolution. These increases brought about more conservation, more efficient use of petroleum products, and greater use of other fuels.

As the chart shows, we expect demand for petroleum products to increase less than 1% per year through the year 2000, when it will still be well below the 1978 peak.

Thus the U.S. has a good deal of excess refining and marketing capacity that was built to meet the nation's needs when demand was higher - and some built in the expectation that demand would continue to grow - that won't ever be needed.

Some of this excess capacity has already been shut down, and more will be shut down in the future. Mergers of this kind are an efficient way to bring about the restructuring and consolidation of the oil industry that is both desirable and inevitable. Eventually this will leave the U.S. with an efficient and viable refining and marketing plant sized to its needs - including some reserve capacity.

This has been a digression in my comments on why the prices of oil company stocks are low. To sum up, they are low because demand has flattened out and there is so much surplus capacity, which led to lower earnings and earnings projections. Oil stock prices tend to reflect this situation rather than underlying asset values.

However, we, and apparently some others, believe that the true value of the shares of some of these companies is considerably greater than the value the market now places on them. Thus, we have been alert for some time to the possibility that we might be invited to participate in a friendly merger that would increase our shareholders' values at an attractive price.

Why Socal Merged With Gulf

We went into this merger because we saw it as having a number of advantages:

- It was made on a friendly basis, in response to an invitation from Gulf. Thus, we look forward to good and productive relationships with Gulf's management and employees.

- It substantially increases our company's assets - particularly oil and gas reserves - at an attractive price.

- The merged companies are an excellent match geographically and functionally in most important categories. In terms of oil and gas reserves, both Socal and Gulf are active in the North Sea. Socal has a major position in Indonesia, Australia, and the Sudan, and important historic ties in Saudi Arabia, while Gulf's other foreign activities are concentrated in West Africa. Domestically, Socal is an industry leader in exploration in California, Louisiana, and in the Wyoming Overthrust area. Gulf is strong in Texas, and both have significant operations in the Gulf of

Mexico. In marketing, Socal is the largest gasoline marketer in the Southeast and on the West Coast. Gulf is strongly represented in the Northeast and Southeast.

o The merger creates a stronger energy firm, technically and financially able to compete more efficiently in the domestic and international petroleum business.

Technical research on how to find and produce oil more effectively will be a key to increasing the nation's oil and gas supplies in the years ahead. We believe the combination of Socal's and Gulf's advanced research efforts will enable us to show outstanding results.

The increasing costs and risks of developing reserves in frontier areas, both in the United States and abroad, require that companies be larger and stronger technically and financially if they are to explore and develop these prospects. In my view, large companies clearly serve the national interest in developing these frontier areas. It is also in the national interest to have companies that are strong enough to compete with large foreign oil companies - many supported by their governments - in acquiring and developing concessions abroad.

These were the chief business and economic considerations that motivated us to merge with Gulf.

Let me also say a word about the role of tax considerations in our thinking, for there has been some misunderstanding about this. Our consideration of taxes in connection with the merger was simply to assure that they did not stand in the way of the business considerations. The idea of gaining tax benefits from the merger played absolutely no part in our thinking.

How Socal Plans to Implement the Merger

Our merger agreement with Gulf was signed only a very short time ago. I hope, therefore, that the subcommittee will understand if I am not able at this time to provide a detailed plan on how we will proceed from here.

We have, however, developed some guidelines that we believe will result in an efficient and humane redeployment of Gulf's assets and people.

- We believe that Gulf has a value as a going concern in excess of the value of its assets alone. We mean to protect this value by maintaining Gulf's operations as going concerns until they are integrated with our own operations or absorbed into some other company's operations.

- Socal may be required to divest itself of some of Gulf's refining and marketing operations in order to comply with the antitrust laws. We plan to work with the Federal Trade Commission and other government agencies to do whatever is reasonably required to be in compliance.

- If it becomes necessary to divest business operations, we believe it is desirable to do so in "packages" designed to be commercially viable, rather than in pieces that may not have the strength to survive. To do this we may divest some additional parts of Gulf beyond those required to comply with antitrust laws.

- So far as we know, there are no antitrust problems associated with merging all of Gulf's exploration and producing operations with ours. As I indicated earlier, we expect to conduct a very strong exploratory program in the future. We view the acquisition of Gulf's reserves as an addition to our ongoing exploration program.

- Gulf Corporation has been negotiating for the sale of its 60% interest in Gulf Canada. We will continue to explore this possibility.

- We have not had the opportunity to determine how Gulf's coal, chemical and nuclear operations may fit with Socal's operations. We will be giving this careful study as soon as possible.

Effects of the Merger

I would like to say a few words about some groups of people that will be affected by the merger. I would also like to comment on its effect on competition in the oil industry, on the cost and availability of credit, and on tax payments to the U.S. Treasury.

First, the people involved in the merger. Mergers of this kind inevitably involve some consolidation of operations. Also, the FTC may require Socal to divest some of Gulf's operations to comply with the antitrust laws.

It is impossible to know now just how employees will be affected. But I would like to assure you - as well as Gulf's employees - that we will do all we can to make the changes required with full consideration for the people involved. Our company has a longstanding reputation for treating its people well, and for handling people involved in organizational changes of this kind with consideration. We value this reputation, and we intend to handle this merger in a way that will entitle us to keep it.

I would also like to comment on the impact of the merger on Gulf's jobbers, retail dealers, and customers. Gulf serves gasoline markets in 26 states. As with other aspects of the merger, it is impossible now to say exactly what arrangements will be made with respect to these operations. But I would like to assure the committee - as well as Gulf's jobbers, retail dealers, and customers - that we will attempt to assure, insofar as we reasonably can, that they will continue to have access to an adequate supply of petroleum products. All of Gulf's current supply contracts with jobbers and dealers will be honored by Gulf and Socal consistent with FTC requirements.

The impact of a merger on competition is, of course, a matter of public concern. The petroleum industry is well-known for its absence of economic concentration. After our merger with Gulf we will represent about 7% of U.S. oil production, 14% of U.S. refinery capacity, and 11% of U.S. petroleum product sales. These are hardly numbers to cause concern. The latter two percentages will be smaller if, as seems likely, the FTC requires us to divest ourselves of some of Gulf's refining and marketing operations.

As I believe you know, the United States oil industry is very unconcentrated in terms of the percent of the market held by the larger companies. It also has an extremely large number of participating companies. There are about 10,000 active exploration and production companies of all sizes. There are over 130 separate companies that own and operate refineries. There are about 15,000 wholesalers and countless independent trucking companies involved in distributing and marketing petroleum products. And finally, the vast majority of the nation's 140,000 retail service station outlets are operated as separate businesses by independent dealers. These high participation rates suggest that barriers to entry are relatively low and that smaller companies can compete effectively in all phases of the business.

Many oil companies, of course, are large. They are large because vast amounts of capital are needed to find and develop reserves of oil and gas, to refine crude oil into useful products, and to make it available wherever it is needed.

The oil industry as a whole is large because the energy needs of the nation are large. The value of petroleum products shipped from this nation's refineries amounts to over half a billion dollars a day - nearly three times the value of the cars and trucks shipped daily from our automobile factories.

Moreover, U.S. oil companies compete with very large oil companies headquartered abroad. Many of these companies are backed by the resources of their governments. It is interesting to note that Japan has recently discussed requiring a number of its oil companies to combine so that each group will have a minimum of 10% of the market. Similar trends toward increasing size can be seen in other foreign oil companies.

I would also like to comment on the concern which has been expressed that Socal's borrowing in connection with the merger will deprive other borrowers of credit and drive interest rates up -- a concern which is frequently translated into arguments that we enjoy a tax "subsidy" because interest on our borrowing is deductible against our income taxes.

With respect to the tax "subsidy" argument, it seems rather far-fetched to me, considering all the borrowing that is done in this country, and all the interest that is taken as tax deductions, to pick out this legitimate business transaction as the one on which the tax deductibility of interest payments represents a "subsidy."

We believe Socal's borrowing for the merger will have a negligible effect on the credit markets, even if we borrow the entire $13.2 billion required.

First, such borrowing does not reduce the amount of credit available, but rather recycles the proceeds to the shareholders of the acquired corporation. Gulf's shareholders will pay federal and state taxes on the $13.2 billion they receive. Of course, we do not know the exact amount of taxes that will be paid, but we estimate that they will be approximately $1.5 to $2 billion. These taxes will reduce government borrowing, so they will not add to credit demand. The rest of the $13.2 billion will continue to be regarded by Gulf shareholders as capital, and will be reinvested in the capital markets, including oil exploration and production ventures. Acquisitions, whether they are made for stock or cash, do not destroy capital. The capital is still there. Stockholders are not going to put the cash they receive from selling their stock in the attic and take it out of circulation. They are going to reinvest it. The proceeds will remain a part of the nation's capital resources, available to meet other capital needs.

Second, the impact on interest rates of borrowing even an amount as large as $13.2 billion will be minimal, since even this amount represents only one-twentieth of one percent of the $30 trillion gross transactions undertaken in the equity market last year, as Mr. Leif Olsen, Chairman of the Economic Policy Committee of Citibank, testified at a recent hearing.

Moreover, I think it is very questionable whether the Treasury will lose money by this transaction. The main tax event from this merger will be, as I mentioned earlier, the receipt of the better part of $2 billion in taxes on the gains of Gulf shareholders. It should be remembered that our tax-deductible interest payment is in most cases some lender's taxable income. Also, as I mentioned, Gulf's shareholders will no doubt put most of the $13.2 billion they will receive, after paying their taxes, into other investments. Income from most of these investments will be taxable, so here again the Treasury will gain.

No one has enough information on the money flows and tax payments resulting from the merger to estimate accurately how this would come out. Even without such a calculation, however, it should be clear that the "subsidy" question is much more complex than its proponents believe, and there is reason to believe the Treasury will do very well.

With respect to a further argument that the interest we will pay on our borrowings will somehow shortchange our exploration programs, let me say two things:

The first is that I have already assured the subcommittee that we place a very high priority on exploration, and that we plan to conduct an exploratory program in the future comparable in effort to the programs the two companies would have carried forward by themselves.

The second is that, as you can imagine, we have done rather careful cash flow studies to be sure the merger is financially feasible. Gulf's earnings last year were $978 million. Although our interest costs initially will be at a rate in excess of $600 million a year after tax, most of this amount will be offset by savings of almost $500 million from not having to pay dividends to Gulf's shareholders. Thus we expect Gulf to generate enough funds to carry its full share of the combined exploratory program I've referred to above.

Some people seem to feel that a merger between oil companies should be viewed with suspicion because of a general misunderstanding that all oil companies are unusually profitable. I wish that were true. The fact is, however, that the average rate of return on equity for U.S. industry as a whole in 1982, the most recent year available, was 11.0%. The figure for Socal was 10.6%, and for Gulf 9.1%. The relationship is similar if one measures the return on total capital employed. Thus Socal and Gulf were slightly less profitable than U.S. business as a whole.

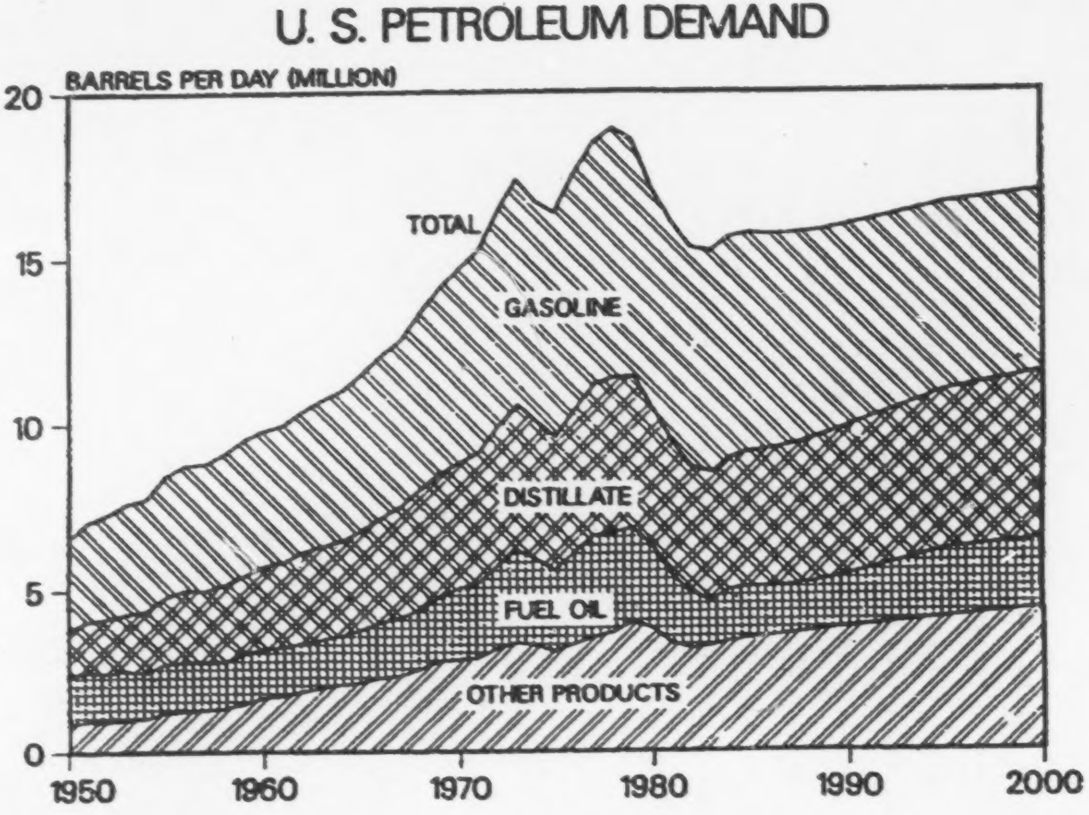
Conclusion

I would like to close by expressing my view that the interests of all the parties concerned, and the national interest, are better served by a merger between Socal and Gulf than by any other realistic alternative.

As I said earlier, the Socal-Gulf merger will result in an exploratory program comparable in effort to the combined programs of the two companies before the merger, strengthened by the stimulating effects of combining our technical and research resources. Gulf's refining and marketing organizations will be operated as going businesses until they are merged into Socal or reoriented in new directions. A large number of Gulf's employees will continue to enjoy stimulating and productive jobs in the merged companies, and all employees affected by the merger will be provided for in keeping with Socal's long-standing personnel practices. Gulf's jobbers, dealers, and customers will be assured that Gulf's contracts will be honored and that insofar as possible they will have a reliable supply of petroleum products.

Looking at the nation as a whole, there will be no change in the very active competition that exists at all levels in the oil industry. There will be no significant impact on the nation's money supply, or on the cost or availability of credit. The tax deductibility of our interest payments represents no more of a subsidy than the deductibility of interest payments on other business and personal borrowing. And there should be no loss of revenue, and perhaps even a gain, in payments to the U.S. Treasury.

Attachment 1



U. S. PETROLEUM DEMAND

STATEMENT OF JAMES L. MURDY, EXECUTIVE VICE PRESIDENT, GULF CORP.

Mr. MURDY. Good morning. I am Jim Murdy, executive vice president of Gulf Corp. Thanks for this chance to comment on the Socal/Gulf merger.

In previous testimony before the Senate Judiciary Committee and the Senate Finance Committee, we have explained the events which led the Gulf board to find a merger partner. Rather than repeat those remarks here, I will refer you to the records of those earlier hearings.

There were two primary concerns leading to Gulf's agreement to a friendly merger with Socal. The first was our responsibility to act in the best interests of our shareholders, our employees, and our customers. The second, and equally important concern, was our responsibility to the Nation and to its energy security goals.

Since energy is the key concern of this committee, I will take a couple of minutes to explain how the actions of the Gulf board, in rejecting the cash-out-now proposals of certain dissident shareholders, were consistent with national energy goals.

During the last 2 years, Gulf has selected critical new directions for capital investment strategies in the United States.

First, we are more aggressive in frontier exploration and in the research necessary to be successful in the frontiers.

Second, we stepped up the level of spending and research on enhanced recovery. This is quite significant since Gulf has nearly 9 billion barrels of domestic crude oil in place in depleted fields. Research breakthroughs which recover more of those reserves are going to be very important to the U.S. energy picture.

A third area of serious effort has concentrated on improving the efficiency of current production.

A fourth decision has been to maintain our position in alternate fuels. Obviously the drop in demand and soft price forecasts have delayed a number of plans in the synfuels area. But we have consciously made sustaining investments in resources and have kept the core technical people necessary to move back into these areas when economics make sense.

Finally, we have completed new investments in our refineries to process a wide variety of crude oil and improve operating and marketing efficiencies in a very large way. Those moves were important to the value of our corporation. They were also consistent with national priorities.

In those strategic areas, Gulf had quite a bit of success last year. We improved the quality and quantity of our frontier acreage.

We put a drilling program in place which could be extremely important to industry prospects in new exploration areas.

We continued to build production from enhanced recovery to the point that nearly 10 percent of our production today comes from those projects.

We improved conventional production. In 1983, for the first time in more than 10 years, we produced more crude oil than we had in the previous year.

And, finally, our domestic exploration was the most successful in nearly a decade since we replaced 70 percent of the crude oil we produced.

When our board looked at the success we were experiencing in these important areas, they decided it was not in the interest of our shareholders to accept any of the short-term oriented, cash-out-now approaches that speculators in our stock were demanding. The board recognized that the tremendous turnover in our shares had put speculators in a position where they stood a good chance of electing their slate of directors at our next annual meeting.

Rather than jeopardize our shareholder values and rather than waste the technical and operating gains I have just described, our board felt the most responsible move it could make was to seek a friendly merger with a strong company, a company which could get full value out of our operations and continue the important gains we had made.

That is why we feel the merger with Socal makes the most sense to our shareholders, to our employees, our jobbers, our customers, and also to this country.

Thank you. I will be pleased to answer any questions you may have.

[The prepared statement of Mr. Murdy follows:]

TESTIMONY

OF

JAMES L. MURDY

GULF CORPORATION

BEFORE

SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES

OF THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

April 10, 1984

Washington, D. C.

Good morning. I'm Jim Murdy, Executive Vice President of Gulf Corporation. Thanks for this chance to comment on the Socal/Gulf merger.

In previous testimony before the Senate Judiciary Committee and the Senate Finance Committee, we've explained the events which led the Gulf Board to find a merger partner. Rather than repeat those remarks here, I'll refer you to the records of those earlier hearings.

There were two primary concerns leading to Gulf's agreement to a friendly merger with Socal. The first was our responsibility to act in the best interests of our shareholders, employees and customers. The second -- and equally important concern -- was our responsibility to the nation and to its energy security goals.

Since energy is the key concern of this Committee, I'll take a couple of minutes to explain how the actions of the Gulf Board, in rejecting the "cash-out-now" proposals of certain dissident shareholders, were consistent with national energy goals.

During the last two years, Gulf has selected critical new directions for capital investment strategies in the U.S.

First, we are more aggressive in frontier exploration and in the research necessary to be successful in the frontiers.

Second, we stepped up the level of spending and research on enhanced recovery. This is particularly significant in our corporation, since Gulf has nearly nine billion barrels of domestic crude oil in place in depleted fields. Research breakthroughs which recover more of those reserves are going to be very important to the U.S. energy picture.

A third area of serious effort has concentrated on improving the efficiency of current production.

A fourth piece of our strategy has been to maintain our position in alternate fuels. Obviously the drop in demand and soft price forecasts have delayed a number of plans in the synfuels area. But, we have consciously made sustaining investments in resources and have kept the core technical people necessary to move back into these areas when economics make sense.

Finally, we have completed new investments in our refineries to process a wide variety of crude oil and improve operating and marketing efficiencies in a very large way. Those moves were important in improving the value of our corporation. They were also consistent with national priorities.

In those strategic areas, Gulf had quite a bit of success last year.

- We improved the quality and quantity of our frontier acreage.

- o We put a drilling program in place to test several new prospects which could be extremely important to industry prospects in new exploration areas.
- o We continued to build production from enhanced recovery to the point that nearly ten percent of our production today comes from those projects.
- o We improved conventional production. In 1983, for the first time in more than ten years, we produced more crude oil than we did in the previous year.
- o And finally our domestic exploration was the most successful in nearly a decade since we replaced seventy percent of the crude oil we produced.

When our Board looked at the success we were beginning to experience in these very important areas, they decided it was not in the interest of our shareholders to accept any of the short-term oriented, cash-out-now approaches that speculators in our stock were demanding. The Board recognized that the tremendous turnover in our shares had put speculators in a position where they stood a good chance of electing their slate of directors at our next annual meeting.

Rather than jeopardize our shareholder values and rather than waste the technical and operating gains I've just described, our Board felt the most responsible move it could make was to seek a friendly merger with a strong company -- a strong company which could get full value out of our operations and continue the important gains we had made. That's why we feel the merger with Socal makes the most sense to our shareholders, to our employees, our jobbers, our customers, and also to this country.

Thank you. I'll be pleased to answer any questions you may have.

Senator WARNER. The committee will soon see the important testimony from those representing the consumer organizations. I would like to offer you the opportunity to comment on what you think the proposed mergers will result in in terms of the effects on consumers.

Mr. DERR. Well, a couple of points, Mr. Chairman. There is certainly absolutely no indication that mergers which meet the antitrust guidelines, and of course they must to get approved, will have any upward effect on the petroleum prices in this country. In fact, second, as I indicated in my statement, we feel that the refining and marketing segment of the business today has significant excess capacity.

I think that mergers will result long term in a more efficient refining and marketing segment, which directly should result in lower prices to the consumers.

Mr. MURDY. I would agree with those comments.

Senator WARNER. Thank you very much, gentlemen. We will now proceed with the next panel which is headed by William Tavoulareas, president of Mobil Corp.

STATEMENT OF WILLIAM P. TAVOULAREAS, PRESIDENT, MOBIL CORP.

Mr. TAVOULAREAS. Thank you, Mr. Chairman. My name is William Tavoulareas. I am president of the Mobil Corp. I appreciate the invitation you have extended to me to testify today. On March 15, I testified before the Senate Judiciary Committee and commented on the pending oil company moratorium legislation on the Mobil/Superior merger.

Mr. Chairman, I am going to abbreviate my statement, but the entire statement will be available for the record.

In my earlier testimony before the Judiciary Committee, I presented in detail the arguments against the moratorium proposal. The legislation then before the Senate would not benefit the country, the consumer, and would be unnecessarily unfair to the ordinary shareholder. It would adversely discourage and impede free market forces.

It was discriminatory not only in singling out one industry but also in singling out only certain companies in that industry.

I also touched upon the concern over the effect on the financial markets due to the merger transactions. Much of the money will be immediately recycled into the economy and a good bit comes from abroad and, in the Mobil case, from the issue of debt securities. In this regard, I would suggest that you may want to receive testimony of those experts in the financial fields who are more qualified to testify about this subject than I am.

Finally, I suggested that if there were to be legislation on specific studies of any kind, let it be directed against the corporate raider or the leveraged takeover specialist whose activities are of questionable economic utility as distinguished from the normal freedom of the market to buy and sell.

I would like to now amplify my previous remarks on the concerns being expressed about the effect of mergers on exploration in the United States. I am convinced that actual exploration for new reserves will not be adversely impacted by the mergers. In fact, speaking for Mobil and its merger with Superior, we submit that the combined company will be more effective and better positioned to meet the challenge of exploring for and developing our domestic energy resources.

Perhaps the recent debate and the call for committee study has had a good result in one area. In focusing on the question of what affects exploration in this country, it may lead to a thorough review of what has been done in the past and what needs to be done in the future by both industry and the Congress in order to maximize this activity.

To properly conduct such a review, we need a clear understanding of what truly affects exploration. Investment in exploration is solely dependent upon two factors, geologic opportunities and economic incentives. Available capital has never been the constraint. Recent mergers will not divert funds from this capital availability. Given geologically and economically attractive prospects, investments will be made.

To the extent that there has been a decrease in exploration, it has not been due to a lack of available capital or a market for exploration. The answer is to be found in examining the opportunities and the diminished incentives.

Everyone should realize that there are fewer domestic prospects today and fewer large reserve areas to be found. It is unlikely that we will be able to find enough geological opportunities to permit us to replace all the production we need for the United States in the long term. But we must continue to look for and develop those economically attractive reserves that do remain. Some of those opportunities are in the very risky and expensive offshore and frontier areas.

We participated in the recent drilling of a well in the Mukluk project in the Beaufort Sea off Alaska which, as you probably know, was a dry hole. We were happy to drill that prospect, because the potential there was very large. Nevertheless, if this large structure on further exploration turns out to be dry, we will have eliminated yet one more area in the frontier region where we had hoped to find large quantities of oil and gas.

As such disappointments occur, it is clear the industry will be paying less for bonuses for new leases. But this does not mean we are losing interest in exploration. It merely means the risks are higher than we had previously thought them to be. We will still have to do much of the same drilling on these leases as we did before. I want to emphasize that you should not equate a drop in bonus bids, which seems likely to occur, with the assumption that we are thereby reducing exploration.

For example, the bonuses on the Mukluk prospect were perhaps $1.5 billion, while the well, which was the real exploratory—really the only exploratory investment, was $120 million including the gravel island.

Compounding the risk factors are the outlook for oil prices. Just a few years ago our forecast of crude prices in 1990 was a range of $69 to $97 a barrel. Today our forecast is for a little over $35 a barrel on the same date. This change has a significant effect on our projected economics for exploration.

We should keep in mind that actions by the Congress have also created large disincentives. An objective reexamination and reversal of some of these actions would go a long way toward increasing the incentive for investment.

I recognize that oil and gas are a legitimate source of tax revenue. But we are at the point when the tax burdens on this basic energy source have had a real effect on the cost of energy for the American industry and on the ability of the oil and gas industry to seek out and develop attractive new sources.

Starting over a decade ago, Congress has taken several steps which effectively reduce U.S. exploration activity. While I have no desire to renew the depletion-allowance battle, the fact is its repeal did reduce incentives. More recently, of course, is the so-called windfall-profits tax. Aside from reducing the economic incentives to explore, it directly reduces the amount of funds available for exploration and increases the attractiveness of nonexploration investments.

I also find it interesting that at the time so much attention was being paid to the need for exploration, the House has reported a bill which would increase the tax in 1984 on newly discovered oil and would alter the decreases scheduled under existing legislation.

Other areas that need to be reexamined by Congress include the continuing price controls on natural gas and OCS leasing moratoria.

Senator **Warner**. The Chair has announced that we will take a recess at 11 until 11:10. We will resume at 11:10 with your testimony.

The committee stands in recess.

[Whereupon, a recess was taken.]

Senator **Warner**. Please continue, Mr. Tavoulareas.

Mr. **Tavoulareas**. I believe the overall issue before us is whether or not our actions and congressional actions are counterproductive to the goal we all seek, that of increasing our domestic energy resources to the maximum extent feasible. Recent merger activity is not counterproductive, and as I have mentioned, it certainly is not so in the case of Mobil/Superior.

Speaking further for Mobil, our top priority for investment has and will continue to be the search for oil and gas in the United States. In the last 10 years we have spent $18.7 billion on worldwide exploration and production. Of that amount $11.9 billion has been domestic. There has never been a time when there has not been enough money for us to take advantage of attractive exploratory plays which we could find in the United States.

We expect to do so in the future so long as we can find prospects to drill and so long as we have incentives to do so. Our ability to do so will to a great extent be dependent upon the actions that you in Congress take.

It should be clear to everyone that the mergers taking place in the oil industry are part of a larger industry restructuring, a restructuring that is reflective of changes in worldwide energy demand and general economic conditions.

We have seen in the past decade industries which have either been unresponsive or slow to respond to changing conditions and as a result have been unable to adequately compete. Without being critical, I would simply mention the steel industry and the auto industry. I am sure the last thing Congress would want is a U.S. energy industry whose structure is antiquated and inadequate to meet its responsibilities for the future.

In simple terms, these mergers are responsive to changing market conditions. If the Congress interferes with those responses, the result will be industries which are unable to adequately respond. History has shown that failure to respond to market conditions leads to inefficiencies and ultimately to a failure to adequately meet consumers' and the Nation's needs.

In the last analysis, our best insurance for energy supply and moderate prices for the consumer is to generate surplus reserves. We would prefer to find those reserves in the United States, but we recognize that much of the geologic potential is overseas. We need to have an industry that is strong and able to compete for all of the new sources of oil supply and that should be our objective in considering the structuring of our industry.

Before I finish, I would like to comment very briefly on one of the Senator's comments at the beginning of this hearing. He talked about a number of things exploration, Gulf and Socal, which I thought they answered, about interest rates, but then he got onto a subject which I have heard other people talk about, which I think he does not understand the problem.

He talks about intangible drilling and he calls it a tax break. What intangible drilling is, he was talking about breaks that the majors got and how they use those breaks in order to acquire. We do not get any more breaks on intangible drilling than anybody else does. All that provision is is when you drill for a well, the cost of that well could be written off in that year. It is as simple as that.

We cannot write off more than the cost. That is all intangible drilling does and it goes right across the oil industry.

Now when he gets over into percentage depletion, the majors have not had a percentage depletion, I think, for almost 10 years. And I keep hearing it said, I heard it said by a Senator at the previous hearing, we do not have a percentage depletion. We have not had it, I think, for 10 years, since the legislation was enacted. There are some independents that have a minimum amount of production a day. They have a percentage depletion. So that tax break we do not have.

Then he talked about a tax break of cost depletion. That is beyond my comprehension. All cost depletion is is the cost of the well can be written off over a period of time or the cost of a lease can be written off over a period of time. That is just an ordinary deduction. There is nothing that is a tax break in that area, like anybody else writes off a business expense.

That is the end of my testimony.

[The prepared statement of Mr. Tavoulareas follows:]

Statement of
William P. Tavoulareas
President, Mobil Corporation
before the
Senate Energy and Natural Resources
Subcommittee on Energy and
Mineral Resources

April 10, 1984

My name is William P. Tavoulareas. I am President of Mobil Corporation. I appreciate the invitation you have extended to me to testify today. On March 15, 1984, I testified before the Senate Judiciary Committee and commented on the pending oil company moratorium legislation and on the Mobil-Superior merger. I do want to take this opportunity to applaud the recent resolution by the U.S. Senate calling for committee studies of all aspects of this issue while rejecting hasty and unneeded retroactive intervention in the free market process.

In my earlier testimony before the Judiciary Committee I presented in detail the arguments against the moratorium proposal. Today I will briefly review those.

The legislation then before the Senate would not benefit the country, the consumer and would be unnecessarily unfair to the ordinary shareholder. It would adversely discourage and impede free market forces.

I noted that the moratorium being proposed was discriminatory not only in singling out one industry; but also in singling out only certain companies in that industry. If a moratorium was needed, it should apply across the board to all industries. Furthermore, the legislation was not needed in view of the ample authority under existing anti-trust laws to prevent or restrict mergers that threatened competition.

One of the serious problems I found with the proposal then before the Senate was its retroactivity. It is very important for people to have the opportunity to enter into business transactions with the expectation and assurance that their deals can be implemented without the risk that Congress will intervene after the fact by rewriting the rules. Moreover, such action is particularly unfair to shareholders, including many pension funds and charitable institutions who stand to gain from the enhanced value of their stock.

I also touched upon the concern over the effect on the financial markets due to merger transactions. It is my view that there is virtually no effect on the credit capacity of our financial institutions as a result of these mergers. Much of the money will be immediately recycled into the economy, and a good bit of it comes from abroad and, in the Mobil case, from the issue of debt securities. Moreover, the amount of money involved is only a minute part of the overall credit market in this country. In this regard I would suggest that you might want to receive testimony of those experts in the financial fields who are more qualified to testify as to the effect on the financial markets.

Finally, I suggested that if there were to be legislation or specific studies of any kind, let it be directed against the corporate raider or leveraged takeover specialist whose activities are of questionable economic utility as distinguished from those who freely agree to buy and to sell.

I would like to now amplify my previous remarks on the concerns being expressed about the effect of mergers on exploration in the United States. I am convinced that actual exploration for new reserves will not be adversely impacted by mergers. In fact, speaking for Mobil and it's merger with Superior, we submit that the combined company will be more effective and better positioned to meet the challenge of exploring for and developing our domestic energy resources.

Perhaps the recent debate on moratoria and the call for committee study has had a good result in one area. In focusing on the question of what affects exploration in this country, it may lead to a thorough review of what has been done in the past and what needs to be done in the future by both industry and the Congress in order to maximize this activity. To properly conduct such a review, we need a clear understanding of what truly affects exploration.

Investment in exploration is solely dependent upon two factors -- geologic opportunities and economic incentives. Available capital has not been the constraint. Recent mergers will not divert funds from this capital availability. Given geologically and economically attractive prospects, investments will be made.

To the extent that there has been a decrease in exploration, it has not been due to lack of available capital or a market for exploration. The answer is to be found in examining the opportunities and the diminished incentives.

Everyone should realize that there are fewer domestic prospects today and fewer large reserve areas to be found. It is unlikely that we will be able to find enough geological opportunities to permit us to replace all the production we will need for the United States in the long term. But we must continue to look for and develop those economically attractive reserves that do remain. Some of those opportunities are in the very risky and expensive offshore and frontier areas.

We participated in the recent drilling of a well in the Mukluk project in the Beaufort Sea off Alaska which, as you probably know, was a dry hole. We were happy to drill that prospect because the potential there was very large. Nevertheless, if this large structure on further exploration turns out to be dry, we will have eliminated yet one more area in the frontier exploration regions where we had hoped to find large quantities of oil and gas. As such disappointments occur, it is clear the industry will be paying less for bonuses for new leases. But this does not mean we are losing interest in exploration; it merely means the risks are higher than we had previously thought them to be. We will still have to do much the same drilling on these leases as we did before, and I want to emphasize that you should not equate a drop in bonus bids -- which seems likely to occur -- with the assumption that we are thereby reducing exploration. For example, the bonuses on the Mukluk prospect were perhaps $1.5 billion, while the well -- which was the real exploratory investment -- was $120 million, including the gravel island.

Compounding the risk factors are the ever-increasing costs of drilling and the outlook for oil prices. Just a few years ago our forecast of crude prices in 1990 was a range of $69 to $97 a barrel; today, our forecast is for a little over $35 a barrel on the same date. This change has a significant effect on our projected economics for exploration. We should keep in mind that actions by the Congress have also created large disincentives. An objective reexamination and reversal of some of these actions would go a long way towards increasing the incentive for investment.

I recognize that oil and gas are a legitimate source of tax revenue. But we are at a point when the tax burdens on this basic energy source have had a very real effect on the cost of energy for American industry and on the ability of the oil and gas industry to seek out and develop attractive new sources. Starting over a decade ago, Congress had taken several steps which effectively reduce U.S. E&P activity. While I have no desire to renew the depletion allowance battle, the fact is its repeal did reduce incentives. More recently, of course, is the so-called windfall profits tax. Aside from reducing the economic incentives to explore, it directly reduces the amount of available funds for exploration and increases the attractiveness of non-exploration investments. I also find it interesting that at the time so much attention was being paid to the need for exploration, the House has reported a bill which would increase the tax for 1984 on newly-discovered oil and would alter the decreases scheduled under existing legislation. I always believed it made no sense to have any windfall tax on newly-discovered oil. How can there be a windfall on what you have not discovered? The tax simply makes uneconomical the exploration of certain prospects and leaves in the ground some oil yet to be found.

Other areas that need to be reexamined by the Congress include the continuing price controls on natural gas and OCS leasing moratoria. Although we believe that offshore prospects are diminshing and are relegated more and more to the riskier frontier areas, the Congress nevertheless ties up some of the better prospects. Further, a thorough review is needed of the multitude of regulatory restrictions that unduly hamper and increase the time and cost of offshore drilling.

I believe the overall issue before us is whether or not our actions and congressional actions are counter-productive to the goal we all seek, that of increasing our domestic energy resources to the maximum extent feasible. Recent merger activity is not counter-productive, and as I've mentioned, is certainly in the case of

Mobil-Superior a positive step. Speaking further for Mobil, our top priority for investment has and will continue to be the search for gas and oil in the United States. In the last ten years we have spent some $18.7 billion dollars on worldwide exploration and production. Of that amount, $11.9 billion dollars was domestic. There has never been a time when there has not been enough money for us to take advantage of attractive exploratory plays we could find in the United States. We expect to do so in the future so long as we can find prospects to drill and so long as we have incentives to do so. Our ability to do so will, to a great extent, be dependent upon the actions that you take in the Congress.

One final thought, and then I would be pleased to answer any of your questions. It should be clear to everyone that the mergers taking place in the oil industry are part of a larger industry restructuring — a restructuring that is reflective of changes in worldwide energy demand and general economic conditions.

We have seen in the past decade, industries which have either been unresponsive or slow to respond to changing conditions and as a result have been unable to adequately compete. Without being critical, I would simply mention the steel industry and the auto industry. I am sure that the last thing the Congress would want is a U.S. energy industry whose structure is antiquated and inadequate to meet its responsibilities for the future.

In simple terms, these mergers are responsive to changing market conditions. If the Congress interferes with these responses, the result will be industries which are unable to adequately respond. History has shown that failure to respond to market conditions leads to inefficiencies and ultimately to a failure to adequately meet consumers' and the nations needs.

In the last analysis, our best insurance for energy supply and moderate prices for the consumer is to generate surplus reserves. We would prefer to find those reserves in the U.S., but we recognize that much of the geologic potential is overseas. We need to have an industry that is strong and able to compete for all of the new sources of supply, and that should be our objective in considering the structure of the industry.

* * *

4/6/84

Senator WARNER. Thank you. Would you have any comments on the effect to the consumers of the merger activity?

Mr. TAVOULAREAS. I would say that a strong, viable industry in the hands of strong people is the best protection for consumers. In my testimony before the Judiciary Committee, I said you have three types of buyers today in the marketplace of oil companies. One is the raider who comes in, makes a lot of activity, threatens he is going to take over, and in my opinion has no real desire to take over, has a desire to get bought out, and get the stock up, and get somebody else to take over. If he does take over, he sells off leases and cuts exploration. Over a period of time that is bad for the consumer.

The second type is a leverage buy-out specialist. He has not got enough money so he uses the assets he is acquiring. It is called monkey paper in the industry. He tries to buy it. Well, pretty soon he has to sell off the assets in order to meet the interest payments.

And the third is the financially viable buyer who can absorb the company, has earnings of its own strong enough to keep the company going.

So unless we are going to stop a shareholder from selling what a shareholder has bought some years ago—take in the case of Superior, they started the company in the 1920's, I believe, and they are going to stop that which I believe is unconscionable.

Of the three alternatives available, the best alternative for the consumer is to put the company in the hands of a strong financial company, who would be most able to carry on the activities of the company.

Senator WARNER. Thank you very much. Senator Hecht, do you have any questions?

Senator HECHT. No, thank you, Mr. Chairman.

[Subsequent to the hearing Mobil Oil Corp. submitted the following letter:]

Mobil Oil Corporation

SUITE 920
1100 CONNECTICUT AVENUE, N.W.
WASHINGTON, D.C. 20036

June 5, 1984

The Honorable John W. Warner
Chairman, Subcommittee on Energy
and Mineral Resources
Committee on Energy and Natural
Resources
United States Senate
Washington, DC 20510

Dear Senator Warner:

During the Senate Energy Subcommittee on Energy and Mineral Resources hearing of April 10, 1984, Senator Domenici submitted a question to Mr. William P. Tavoulareas, President, Mobil Corporation, regarding the supply of crude oil for refiners in New Mexico.

Attached is a copy of Mobil's response to Senator Domenici. I respectfully request that our response be made a part of the hearing record.

Sincerely,

Barney J. Skladany, Jr.
Government Relations Manager
U.S. Marketing & Refining

BJS:plb
Attachment

cc: Senator Pete V. Domenici

Mobil Oil Corporation

150 EAST 42ND STREET
NEW YORK, NEW YORK 10017

PETER A. SPINA
GENERAL MANAGER
CORPORATE GOVERNMENT RELATIONS

RECEIVED [illegible]

June 1, 1984

Honorable Pete V. Domenici
United States Senate
434 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Senator Domenici:

This letter is in response to the written question provided to William P. Tavoulareas, President, Mobil Corporation, during the Senate Energy Subcommittee on Energy and Mineral Resources hearing of April 10, 1984. The question asked for assurances from Mobil Oil Corporation on continuance of supply of crude oil for refiners in your State who presently purchase from Superior Oil.

You have probably since been informed of the agreements that have been reached on future supply of Four Corners crude. In any case, I have attached a copy of a letter from Allen E. Murray, President of Mobil Oil Corporation to James E. Acridge, President, Giant Industries, Inc. I trust that this correspondence provides the assurances you have sought and will alleviate the concerns you may have relative to the effect on future supply of refined products from this refiner by reason of a Mobil/Superior merger.

Very truly yours,

Peter A. Spina

PAS:vf
Attachment

cc: B. J. Skladany

Mobil Oil Corporation

150 EAST 42ND STREET
NEW YORK, NEW YORK 10017

ALLEN E. MURRAY
PRESIDENT

May 22, 1984

Mr. James E. Acridge
President
Giant Industries, Inc.
P. O. Box 9156
Phoenix, Arizona 85068

Dear Jim:

Thank you for your letter of April 30, 1984. As you know, the FTC has cleared Mobil's acquisition of Superior. We have purchased the Keck/Day shares and presently own 22% of the stock. Our present tender offer will take us up to 51%, which will be followed by a merger.

I'm pleased you and Superior were able to reach a satisfactory five (5) year crude oil agreement and that it will be of benefit to your operations.

While I think you and I have had some very constructive and frank discussions, there was a comment in your letter on which there may have been some misunderstanding. Superior will not stay as an independent crude oil producer and supplier since it will be merged with Mobil; however, we will of course take over their contracts. With respect to the Four Corners crude, I indicated it was our present intention to sell this crude in the area. We both agreed that in the changing oil world it was hard to predict what would happen five (5) years from now or even if production would exist in the area.

I also hope that Giant and Mobil will have a long-term beneficial working relationship. I look forward to meeting you in the near future.

Sincerely,

Allen E. Murray

Senator **Warner**. We will now proceed to panel 4, Mr. Boone Pickens, Mr. Charles Murphy, and Mr. Jon Rex Jones.

STATEMENT OF T. BOONE PICKENS, JR., PRESIDENT AND CHAIRMAN OF THE BOARD, MESA PETROLEUM CO.

Mr. **Pickens**. Thank you, Mr. Chairman. I would like to submit my written statement for the record and I will summarize my written statement.

Senator **Warner**. Without objection. You have testified in previous hearings and you have had the benefit of listening to the preceding testimony and know the subject well and you can certainly summarize and point out those aspects of that testimony you feel should be emphasized.

Mr. **Pickens**. Mr. Chairman, I have the feeling you are asking me to be brief.

Senator **Warner**. No, I do not mean to in any way. I have listened to you and you have a good grasp of the subject matter.

Mr. **Pickens**. Thank you very much. I will in my remarks I will make here for 2 or 3 minutes, I will be speaking to the point that I am frequently identified as a raider or liquidator. I found the predecessor company of Mesa in 1956 and paid in capital of $2,500. We went public in 1964 with assets of less than $2 million. In 1984, 20 years later, we had assets of over $2.5 billion. In 1969, we acquired a production company and we did not release one person in that acquisition and we more than doubled the production in 2 years.

In 1973 we acquired Pubco and I would like the record to show that we were a white knight in that, Mr. Chairman. That is the only time we have ever been a white knight in the field. Unfortunately, the phrase had not been coined at that time. So we sometimes are left out of the list of white knights.

In 1976, we found a major oil field in the North Sea. In 1976 we were the most active operators in Canada. In 1979, we spun off the first royalty trust to our stockholders and in 1982, we filed a second royalty trust to our stockholders. In 1983 we found three oil fields off the coast of Australia. In 1984, after spending $1.5 billions in the Alkan, we had 49 producing platforms. I don't think that is a record of a liquidator.

After mergers and acquisitions the industry, our industry had problems. We have ample cash flow available. We have limited investment opportunities. Our problem stems from the windfall profit tax for natural gas. Oil and gas not found—that is the point I would like to make—not found today are not going to go anywhere. They have been there for hundreds of millions of years. We can drill for prospects in 1985, 1986, 1988 or whatever. So I do not see the great urgency to get out here and spend a lot of money uneconomically.

Our finding costs are too high in the industry and this is one of our primary problems. It may be our primary problem. We are inefficient in the exploration business. I think mergers will bring efficiency back into the industry. I think it will clean up those companies that are managed by weak managers. I think those assets will move into the hands of strong managers. I think the consolidation of operations would be very helpful for the industry and I think we will become much more efficient than we are today.

As to major oil companies borrowing money and making it tough on independents, I do not see that case at all. That is not going to make any problem for the independents. In fact, I would just as soon see the majors borrow as much as they want to and they would start to look like independents and they could play with the same set of rules that we play with.

One thing that you have here in the Senate, or the American people have to check on our industry, and it is a quick and easy check that is available to you every Monday morning and that is to look at the rig count, the rotary rig count, operating rotary rigs in the United States. That will tell you what this industry is doing. It is the best barometer that we have within the industry to check ourselves. We hit a high point in December 1981 of 4,531 rigs. Yesterday, we get it on Monday, we had 2,062 rigs operating, which is about, under 50 percent of the rigs we had at the high water mark. That is 13 straight down weeks we have had now.

On January 4, 1984, that was the first Monday in 1984, we had 2,710 rigs operating, so we are down 648 rigs since the first of the year. This has nothing to do with merger and acquisition activities in the industry. It is very simply the prospects, we do not have enough economically feasible prospects. That is our problem.

I would like to comment specifically on the Socal/Gulf deal. I think it is an obvious case of assets moving from weak hands to strong hands. Socal has an excellent record in the major oil companies. Remember Gulf Oil for 12 straight years failed to replace their annual depletion of domestic reserves. I think it is a point that is oftentimes missed by people who are looking at this situation, that this company, Gulf Oil, is in liquidation.

Senator WARNER. You mean a defacto liquidation?

Mr. PICKENS. In fact, they have—Gulf Oil has not even come close to replacing the depletion of the primary assets of their stockholders. And I ask who is it that looks after the stockholders of these companies? These are the owners and the management of Gulf had already bailed out on their stockholders.

Jim Lee, the CEO, after 42 years with a salary just under $1 million annually owned less, owned just right on 21,000 shares of stock—21,000 shares after 42 years.

The stockholders, I believe, are the forgotten people in a free enterprise system. I wonder who it is that is going to speak up for those people at some point. Remember there are 42 million of them in the United States today by a survey run by the New York Stock Exchange in mid 1983. Forty-two million people in the United States own stock in public owned companies.

If you believe those people have a spouse and you say 80 million people, you are talking about one-third of the people in the United States in one form or another own stock of public owned companies.

In closing, had we taken over Gulf, my wife and I would have moved to Pittsburgh, restored Gulf to the position in the industry it once had and we would have kept the headquarters in Pittsburgh—that is the answer to Senator Heinz's remark earlier—that we had no plan, we had no plan to liquidate Gulf Oil. That concludes my remarks.

Thank you.

Senator **Warner**. Feel free to supplement your remarks for the record.

[The prepared statement of Mr. Pickens follows:]

T. Boone Pickens, Jr., president

MESA
PETROLEUM CO.

STATEMENT OF T. B. PICKENS, JR.
PRESIDENT AND CHAIRMAN OF THE BOARD
MESA PETROLEUM CO.
UNITED STATES SENATE
SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES
HEARING ON OIL INDUSTRY MERGERS
APRIL 10, 1984

Mr. Chairman:

It is a pleasure to appear before you today. I thank you for affording me this opportunity.

Let me briefly summarize the points I intend to make today.

First, the energy industry is in the midst of a major restructuring. This is a healthy development which is being led by shareholders, who have been largely ignored by the management of the major oil companies.

Second, as Mesa's record will verify, mergers can produce a more efficient company and enhance shareholder values. We have enhanced these values through various means, including the creation of royalty trusts.

Third, mergers do not adversely affect drilling activity.

Fourth, it would be counterproductive to enact legislation to prevent merged energy companies from having access to oil and gas resources on the public lands and the Outer Continental Shelf.

Fifth, mergers have no adverse impact on capital markets.

Sixth, anti-merger legislation only serves to entrench the management of the major energy companies, while it damages shareholders and consumers.

Seventh, consumers will benefit from mergers through more efficient management of the merged companies, the injection of new capital into the economy, and the additional tax revenue derived from these transactions, which, incidentally, will reduce the federal deficit.

Eighth, the enactment of anti-merger legislation of any type could adversely affect not only the energy industry but also send shock waves throughout the stock market and create a dangerous precedent the exact impact of which cannot be fully measured in advance.

Ninth, the Senate has convincingly defeated an attempt to impose a moratorium on mergers and should follow that precedent in defeating other anti-merger legislation.

Restructuring the Energy Business -- In the Public Interest

The energy business is in the process of being restructured as it struggles to replace reserves which are being produced. A healthy energy business is absolutely essential to our nation's security, and we must encourage the companies engaged in that industry to solve their problems with a minimal amount of government interference.

As Robert J. Samuelson wrote in the March 21, 1984 issue of The Washington Post:

> "Going after oil mergers won't help. If Congress bars mergers, the industry will shrink by other means . . . Americans love to hate big oil, but we delude ourselves if we think that attacking mergers is a substitute for the steps that might minimize oil's dangers."

The restructuring will continue and the industry will change. It is inevitable.

We interpret the scheduling of this hearing as an indication that your committee is dedicated to following a policy of judicious and careful consideration of any proposed legislation which goes to the heart of our free enterprise system. The Senate is to be congratulated in its decision to utilize the established procedure of review under the committee system rather than legislating by resolution from the Senate floor.

Mesa Petroleum Co. has received considerable publicity in recent months. We have been identified as a group of entrepreneurial people who are quick to seize upon an opportunity to benefit shareholders. We believe the shareholders are the cornerstone of corporate America. There are more than 42 million of these people who have invested in publicly held corporations. The retirement hopes and dreams of millions depend upon the performance of securities held by pension funds and institutions.

We believe that managements frequently ignore their shareholders and easily forget that the shareholders are the owners of the corporation. They are the silent majority who accept abuses by managements and seldom protest. We are strong advocates of shareholder rights, and we make no apology for advancing these rights wherever possible. We are willing to protest when these rights are ignored.

In this capitalistic society, these are our constituents, Senators, just as we are your constituents. Among this constituency are many voters. Elected officials, as well as corporate managers, should listen to these people.

We know something about preserving shareholders' rights. We also know something about mergers and acquisitions and exploring for and finding hydrocarbons. In verification of these statements, allow us to tell you something about our company.

Mesa Petroleum Co.: Increased Efficiency Through Maximizing Shareholder Value

We founded Petroleum Exploration Inc. in 1956 with a capitalization of $2500.00. In 1964, the name was changed to Mesa Petroleum Co. and we became a public corporation. Total assets were less than $2 million. Five years later, we tendered for and acquired another public corporation engaged in the production of hydrocarbons. This company was 20 times the size of Mesa. It had large gas reserves, considerable cash flow and no exploration staff. It was destined to deplete its reserves in a matter of years, which meant the stockholders would deplete their assets and income while the employees ended up with no jobs.

This company was quickly assimilated into Mesa where the cash flow was directed to expanding our exploration activities, employing highly competent scientists and building the reserve base for our shareholders. Three years later, we intervened as a "white knight" in an unfriendly takeover attempt by a hostile suitor and we acquired another energy company. The procedure of assimilation was repeated. In each instance, efficiencies of operation were greatly improved and the return on stockholders' investments was enhanced. No people were laid-off. Some few employees elected to resign rather than move to new locations.

Also, in each instance, the shareholders of those two companies merged into Mesa who elected to take Mesa stock in exchange for their original shares enjoyed significant appreciation in both market value and asset value.

We proved that through acquisitions, a larger, more profitable and vital company could emerge. We also demonstrated that through expanded exploration budgets made possible by the larger cash flows and borrowing base of the combined companies, more oil and gas could be found.

Each year since its inception, Mesa has replaced and enhanced its reserve base. Replacement has been achieved primarily through intensive exploration and development. We have invested over $1.5 billion in offshore exploration and development in the Outer Continental Shelf and have an average interest of 28% in 49 offshore platforms. During the last five years, total additions to Mesa's liquid reserves represented 139 percent of production and additions to natural gas reserves represented 187 percent of production. Our total assets today are in excess of $2.3 billion. Our net income last year was $115 million on revenues of $422 million and we participated in drilling 149 wells.

We are proud of our record. We are less proud of our cost in finding oil and gas in recent years. Industry-wide, the high cost of finding hydrocarbons is the most serious problem facing management. However, there was a time when managements refused to disclose reserves and the shareholders had no knowledge of the extent to which reserves were being depleted and replaced or the cost of finding oil and gas. We initiated the policy of publishing reserve data in our annual report in 1973. Six years later, the SEC passed a regulation requiring all companies to disclose this information. We led the way in providing stockholders with this extremely important data.

The most recent comparison among the Fortune 500 companies shows that Mesa would be included in the top five energy companies in assets and net income per employee, and in net income as a percent of stockholders' equity. An investor who purchased

1,000 shares of Mesa for $10,000 when the company was founded in 1964, as a result of the stock splits and the creation of two royalty trusts, would now have an investment with a market value of approximately $240,000.

Our management has been recognized for its ingenuity, its expertise in finding oil and gas, and its dedication to the shareholders. We have been selected as the best managed among 89 companies in oil and gas production, and the Wall Street Transcript indentified me as the best chief executive among oil producers in 1981 and 1982. Last year, Financial World selected our annual report as one of the three best among companies in the petroleum industry.

Royalty Trusts: A Proven Method To Enhance Shareholder Value

We also know something about royalty trusts and were the first to implement the creation of these trusts for our shareholders. The royalty trust is a method of enhancing shareholder value. We believed that in 1979 when the first trust was created by Mesa, and we continue to advocate the establishment of trusts today. In fact, we see the trust as being of even greater importance to the shareholders in 1984 when so many companies are depleting reserves faster than they are replacing them. This means the primary asset base of the shareholder is rapidly eroding and, in time, the company will be valueless.

There is nothing complicated about creating a royalty trust. An oil and gas company selects some portion of its properties -- producing, non-producing, or a mixture -- and spins out these properties to its shareholders in the form of a royalty interest. The royalty trust interest is passive, and all decisions regarding the operation of the properties and the disposition of the oil and gas produced therefrom are retained by the company. The recipient of the royalty trust unit normally pays income tax based upon the value of that trust unit, continues to pay annual taxes based upon the income received and may pay a tax if the trust unit is later sold. The trust usually is administered by a national bank trustee, which trustee receives the income from the sale of oil and gas, distributes the income to the holders of the trust units and files all reports required by the Securities and Exchange Commission, the stock exchange and other regulatory authorities. The trustee must have its records externally audited and its reports distributed quarterly to the trust unit holders.

As you know, the value of corporate securities is determined by the stock market. Historically, the market ascribes a higher multiple to a royalty trust unit than to a share of stock in most energy companies. The shareholder who elected to hold the stock through the effective date of the trust unit distribution, and thereby receive the trust certificate, would have two stock certificates -- the original corporate share and the new trust unit. Experience has proven that the combined value of the two certificates is considerably in excess of the value of the single corporate security -- but, since the shareholder has received something of value in the form of a trust certificate, there will be a tax liability. That is fair enough. Value received by the shareholder, tax paid by the shareholder.

Since the distributing corporation did not receive any value by virtue of the royalty distribution to the owners, it should not be taxed. To impose a tax at the corporate level would amount to imposing a penalty which would discourage the corporation from creating the trust. This tax would be a "deal killer."

We have observed that when a company announces the creation of a royalty trust, the market price of the corporate shares increases in anticipation of the distribution. The shareholder can elect to sell the corporate stock at the enhanced value before the effective date of the distribution and not be subject to a dividend tax on the trust unit. By selling before the effective date, the shareholder would not be entitled to receive the trust certificate. However, the transaction will be susceptible to a tax on any capital gain incurred by the shareholder. Again -- value received, tax due.

Last December, as the largest shareholder of Gulf Corporation, Mesa and its co-investors requested Gulf to create a royalty trust consisting of 50 percent of its domestic reserves. This trust would have provided the Gulf shareholders with income equaling approximately 25 percent of Gulf's cash flow and would have left Gulf with ample resources to continue a vigorous exploration and production program. The creation of this trust would have generated initial income taxes in excess of $1 billion. Were similar trusts to be created by the ten largest domestically owned integrated oil companies, the initial tax impact would be in excess of $16 billion.

In summation, we strongly argue there are no losers when a royalty trust is created:

- The shareholders experience an enhanced value in their investment and an increase in their annual income.
- The corporation retains control over the disposition of the oil and gas produced from the properties and maintains the ability to look for oil and gas because the cash flows are not unreasonably diminished, and the borrowing base is not significantly reduced.

  Management, by analyzing their prospects and decisions to budget funds more carefully, will be more efficient.
- And, the U.S. Treasury receives increased revenues as a result of the taxes. These are significant taxes.

Mr. Chairman, if a royalty trust does so much for the shareholders, contributes to the efficiency of an energy company and materially increases revenues for the U.S. Treasury, there just is no way it can be identified as a tax loophole. It is a tax producer!

Now, permit me to make a strong and reasoned appeal that you make no change in the current laws regarding corporate mergers or acquisitions in the energy field.

Mergers Do Not Adversely Affect Drilling Activity

The oil and gas business is a highly competitive industry. We have had both good and bad times. Today, the domestic energy business is in trouble. Oil and gas reserves are being depleted faster than they can be replaced. In the last three years, the largest oil companies have averaged replacing less than 66 percent of the amount of hydrocarbons they have produced in the United States. For the period 1978-1982, only two major integrated companies had a replacement rate above the production rate. Consequently, the number of drilling rigs being used in exploration and development continues to decline. In the third week of December 1981, there were 4,431 rigs working. In April 1982 that number had declined to 1,807 rigs. Today, the count is 2,062 rigs. In other words, the drilling decline is not caused by a shortage of capital.

The problem is a scarcity of good drilling prospects, high finding costs and stable prices. There is a serious question whether or not current energy prices afford sufficient economic incentive to explore in frontier areas and the natural gas market is saturated. But there is no question that the energy industry can go through this period of restructuring and still explore for and develop every good prospect available. It is not currently a growth industry but it does possess enormous financial capacity and staying power. After restructuring, it will be better able to provide for the nation's energy needs in the future.

Additionally, to the extent that any of the majors reduce their drilling budgets for any reason, whether it be a lack of good prospects, a corporate or property acquisition or a decision to diversify out of the energy industry, this simply provides a greater opportunity for independent oil and gas producers to negotiate for lease farm outs and other deals. The independents are the real risk takers in the energy business and drill 80 percent of the exploration wells in the domestic U.S.

But, it is not just we who are claiming that mergers will not affect exploration. The New York Times of March 21, 1984 noted as follows:

> "The multibillion-dollar mergers reshaping the American oil industry may also offer new economies of scale that make . . . exploration efforts more fruitful . . ." "Thus, when these separate resources are thrown together in a merger, the reasoning goes, the company that emerges can select its drilling projects from a richer list using the combined and presumably enhanced expertise that also results."

Denying Access to Public Lands and the Outer Continental Shelf Would be Counterproductive

I believe it would be particularly bad economic and energy policy to prohibit merged companies from participating in public lands and Outer Continental Shelf leasing. If the Congress sees a need to consider a special merger policy for energy companies, it should face the issue head-on. It should not confuse the issue by taking arbitrary actions aimed at merged companies through our federal minerals policy. Mergers can improve our ability to explore and develop our natural resources, including the economically risky Outer Continental Shelf. Denying access to federal mineral leases to merged companies will not stop mergers. It will serve only to stifle competition for oil and gas leases and reduce the level of resources which can be brought to bear on some of the most risky but more promising prospects. The biggest losers under this ill-conceived plan would not be Mesa Petroleum or any other energy company. The biggest losers would be the American people who have a legitimate interest in the proper utilization of the natural resources of this nation.

Mergers Have No Adverse Impact on Capital Markets

To say that these mergers drain the resources of this nation and result in a shortage of bank credit generally available to individuals and businesses just is not true. This is a fallacy that is discredited by the recently publicized report of the Securities and Exchange Commission Advisory Committee on Tender Offers. Based on its own experience and study, and supported by Federal Reserve Board Chairman Paul Volcker, the Committee notes that transactions involving acquisitions of control do not distort the credit markets or divert investment from new plants, nor do they limit consumers' ability to obtain credit or deplete credit otherwise available to would-be borrowers. Moreover, the SEC Committee explained that takeover transactions fundamentally involve a transfer of existing assets, not the absorption of new savings, and because the shareholders who sell their stock to an acquiring firm typically reinvest the proceeds, the capital remains in the economy and is made available to others. And these shareholders pay taxes, big taxes.

Dr. Leif H. Olsen, Chairman of the Economic Policy Committee at Citibank, N.A., recently testified before the Senate Judiciary Committee. Dr. Olsen stated that viewing the capital market from a true perspective, in 1983 the equity transactions were in excess of 30 trillion gross dollars. Gross bank lending and investing was more than $4 trillion. A transaction of several billion dollars, while large in absolute terms, is not significant in comparison to the total funds available. Additionally, the trend today is to involve overseas sources as a means of attracting credit and these funds do not impact domestic money supplies for many months.

To recap, financial institutions at home and abroad are awash in liquidity. There is no undersupply of credit. The problem is a scarcity of good drilling prospects, and the depressed price of oil and gas gives little incentive to the explorer. Ample capital is available for viable exploration prospects.

Anti-Merger Legislation Would Entrench Ineffective Management

As stated previously, shareholders should have the option to direct companies to merge when circumstances warrant. Artificially protecting management from the prospect of having to merge removes one more valuable shareholder's right and further insulates insensitive officers from the concerns of their shareholders.

Management inefficiency is one of the basic underlying causes of corporate mergers, including some recent, highly publicized ones. As Assistant Attorney General for Antitrust J. Paul McGrath noted in a recent speech before the National Association of Manufacturers:

> "An active merger market is a healthy threat to incompetent management. If a firm is poorly managed, the price of its stock will likely fall below the level that it could be expected to reach with competent management. This makes the firm an attractive takeover candidate. A takeover in these circumstances is good for the economy because it shifts corporate assets from poor managers to more efficient ones."

Further support for this view has come from economist Michael Jensen, quoted in USA Today on March 21, 1984.

> "The merger market is really part of the labor market for top corporate managers . . . There's no unemployment bureau for CEO's of billion-dollar firms . . . [Managers, directors, and consultants are] appealing for help outside the market -- legislative help to protect them from the market."

I think these views demonstrate that corporate mergers are not motivated by the tax laws or by some kind of quick-profit scheme. These mergers reflect the response of sensible shareholders to market changes and problems with management. The merger is one means by which shareholders exercise the right to run the corporations they rightfully own.

Mergers Do Not Hurt Consumer Prices

The new company will not suffer any diminution in its ability to look for oil and gas, and quite likely will be more operationally efficient; thus, prices of gasoline at the pump will not be adversely affected. Gasoline prices are tied to the price of crude oil and OPEC sets that price. Economic factors within the industry, not mergers, generally dictate the level of employment, and the employment or dismissal of people depends upon the national economy and the profitability of the company. To achieve a higher level of efficiency in a merger, some jobs may be lost; but, this in itself cannot be the primary reason for Congress to legislate against the right of corporate owners -- the shareholders -- to elect to merge. This right, exercised within the restraints imposed by reasonable laws, carefully designed to protect the national interest, must be retained.

Anti-Merger Legislation Will Cause Shock Waves in the Stock Market

We are certain that the reaction in the market would be immediate and disastrous to any action by Congress which would prevent mergers in this industry. Stockholders would be fully justified in viewing the legislation as hostile, ill-conceived and the possible prelude to the creation of a national energy company. The shock waves in the financial community would be far reaching and permanent.

Retroactive Antitrust Legislation: Inequitable Policy and A Dangerous Precedent

Finally, we find it to be totally contrary to the free enterprise system when Congress considers changing the rules under which thousands of shareholders invested in energy companies and threatens to tell these people that they are going to be denied the right to enjoy the fruit of their labor and the profit from their investments.

We object to the form of the various anti-merger proposals, including S. 2362, which appear to me to be retroactive legislation that arbitrarily penalized companies like Mesa. We believe that the Senate wisely rejected the notion of interfering with mergers in the energy industry when it defeated -- by a convincing margin of 57 to 39 -- a legislative proposal to impose a moratorium on mergers. These anti-merger measures would interrupt or terminate business transactions now in progress, seriously harm thousands of shareholders, and harm the interests of all Americans in the proper utilization of our natural resources.

You are at the brink of legislating out of existence a part of the initiative, the determination and the entrepreneurial spirit which is the bedrock of our free enterprise system. This is an awesome responsibility, and I urge you to be most deliberate and cautious before summarily administering a coup de grace of that magnitude.

STATEMENT OF CHARLES H. MURPHY, CHAIRMAN, MURPHY OIL CORP.

Mr. MURPHY. Mr. Chairman, my name is Charles Murphy. I am chairman of Murphy Oil Corp. Our company is probably the smallest of the 20 or so firms that operate on a worldwide basis. The Murphy family owns 35 to 40 percent of the outstanding common capitalization.

We appreciate the invitation to express our views on the subject of mergers and acquisitions. As I understand it, the only bill actually being considered here is Senator Johnston's bill, S. 2362, which calls for a moratorium affording Congress time to study this thing. Our counsel did understand from your staff that the committee will be happy to receive our views, not only on the moratorium itself, but on the broader question of whether and to what extent the Congress should intervene in the rationalization process which has been the theme throughout this morning.

Senator WARNER. I want to make it clear that that option is open to all witnesses.

Mr. MURPHY. Thank you, Senator. I will address the moratorium question first and then offer some comments on the merger question from the perspective of our own company and our conclusions with some general observations as a citizen and taxpayer.

The overriding question on a moratorium is whether we need one at all. Only if we reach a consensus that one is needed do we need to address the technical questions, such as when it should commence, should it prohibit the Gulf/Socal and Mobil/Superior mergers, and whether it should prevent any merger or acquisition, no matter how small, as the proposed bill seems to do.

On the broad question of whether one is needed, it is often difficult to oppose a moratorium. After all, when an issue has aroused public attention, as this one surely has, what could be more reasonable than to ask for an allowance of time so that the matter could be studied and acted on in a considered deliberate manner. The notion of a moratorium is alluring.

The status quo is preserved and theoretically no one is hurt while the Congress has an opportunity to do its job. Nevertheless, I declare myself at the outset as being opposed to the moratorium. On reason, which will become obvious later on, is because I am going to express my opposition to permanent legislation on this subject, but even laying that aside, I am opposed to moratoria on principle.

Life just does not work that way. Would that it did, but it does not. The physician treating a critically ill patient, the general managing a war, the businessman reacting to a competitive situation, all would like to make time stand still so that they could carefully plot and plan their next moves. But it can't be done and it shouldn't be done.

Time is the very essence of life and changes occurring with its passage are by nature and should be inexorable. If we have a problem it should be dealt with appropriately and efficiently under the pressure of time, election year paralysis or no, and if we don't have a problem we should reach a consensus on that so we can get this one out of the way and move on to the next problem.

Too often in the past we have seen this country yield to the temptation of trying to take a snapshot of a situation, an industry, or a group of citizens, such as our blacks, and attempt to hold that snapshot still while we decide what should be done. There is then the further temptation to prolong the scene seen in that snapshot and then there can be only one of two results. Both of them are bad. One result is stagnation through continued extension of the moratorium; the other result is a sudden wrenching change when the dynamics temporarily interrupted by the moratorium can no longer be resisted.

That then is my position on the subject of moratorium—do not do it. It will only make you legislators indolent in addressing the problem, if indeed there is a problem.

Next, I should like to offer some comments from the viewpoint of our own company on the current spate of mergers that are contemplated and are occurring in the industry. Much concern seems to be directed at the use of capital in mergers and acquisitions rather than devoting that capital to exploring for oil and gas. We see this as perhaps having some short-term effects but not necessarily long term.

In the short term, much of the cash flow from the merged company will likely be used to repay debts incurred by the surviving party. Some, if not most, of this cash might have been used for exploration and production and, therefore, exploration might momentarily decline a bit. I will interject here that our company and a number of places in the world, in the department of Socal, high-risk, high-potential areas, we have discerned no effect whatever on their attitude toward pursuing good opportunities after their deal was announced with their targeted company.

Our shareholders have a sizable investment in the offshore contract drilling business and to the extent that exploration suffers, why we might suffer just a bit. We are willing to accept that. But we also conduct an active exploration program and if the dynamics of the situation cause prices of offshore leases to come down, and that point was made a moment ago, we have been paying too much already in these sales, why then a good effect will come to pass and this will make exploration more attractive.

If the system works right, the more attractive exploration opportunities will attract additional investment from other sources and as has been said here already this morning, some of that may come from the former owners of the Gulfs and the Gettys and the Superiors.

Neither are we unduly concerned at this point with a tendency of these mergers to concentrate market share in the downstream end of the business. For many years, we have competed successfully in areas where one of our competitors has from 10 to 20 percent of the market and we feel comfortable that the dynamics of competition and the present array of anticombine laws and regulations will keep this potential problem from getting out of hand. I have no concern whatever about it.

In summary then, we do not feel threatened by recent mergers, even if they are ultimately consummated and therefore shun the need of restrictions on shareholders of other companies while the problem is being studied in more depth. Moratorium on mergers for any extended time period seems to us to be such an unwarranted restriction.

Now, should our views not be accepted and if some legislation containing a moratorium is enacted, we have some problems with the drafting of this specific legislation. We are in other businesses besides oil and gas. Our investment in contract drilling has already been mentioned. We are buyers of a contract drilling company. In addition, we are quite extensively involved in the timber business.

As the bill is now written, we could not acquire a small timber company during the next 6 months without forever forfeiting our right to own new Federal leases. If this is the intended result of the proposed legislation, it seems to be unnecessarily manipulative. We, therefore, would request the committee to consider limiting the penalties for mergers during the moratorium to two substantial energy-reserve holders.

We have no merger of any kind in mind at the moment. Therefore, our objection to the proposed legislation is an objection in principle. It is difficult to foresee the future though and if the moratorium should exist, we might be denied an opportunity.

Finally, not necessarily from the perspective of Murphy Oil, but simply as citizens and taxpayers, we suggest that the following points should be carefully considered by your committee before it recommends enacting any restrictions.

One, inhibiting mergers can lead to lethargy and even stagnation. In large public companies with widely dispersed shareholdings, there won't be any way to oust an inefficient management. Stockholder apathy will increase as the market for their shares is further restricted. If someone can't buy, someone else can't sell.

The merger route can be a way of recycling capital to more efficient use. The Gulf shareholders stand to collect some $13 billion. If they believe that money can be efficiently spent in exploring for oil and gas, they will reinvest one way or another in that effort. On the other hand, if they think that money can be more attractively used by the Government in the form of debt securities they might hold, well, then they will go that way; or by steel companies to rebuild their antiquated plants.

The system we have in place does have some faults, but they can be addressed within the framework of that system. The Sherman and Clayton Acts exist to prevent creation of monopolies in any line of business. Use them; use them in a consistent fashion. Don't single out the oil industry for special treatment.

We would concede that there are flaws in the present system. One of them is that which allows an entrenched management to purchase its continued employment by buying out at a premium a dissident minority shareholder with assets of all shareholders. Another is in the two-tier takeover which permits a raider to acquire the first tranche of a target company's stock for cash at an attractive price, but then squeeze out the remaining shareholders with something other than cash. Then too the present system works to the advantage of speculators. That problem is compounded by the tendency of institutional investors to show short-term results. And the SEC should be thinking about that one, and I understand they are.

But you already have the securities laws administered by the SEC in place to guard shareholders' rights and we feel you should address those problems within that framework.

Next, if it is to be our national policy to force more investment in domestic oil exploration, don't do it by stagnation by freezing the existing companies into a pattern of having nothing else to do with their assets. Do it by removing the existing impediments to oil and gas exploration. Cut back the excise tax on oil, misnamed a windfall profits tax; unshackle natural gas; continue the open lease sales; and ease up on the restrictions on exploring frontier areas. This would not only stimulate existing competitors, but it would attract new ones to the game.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Murphy follows:]

SENATE SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES HEARING
APRIL 10, 1984
TESTIMONY OF CHARLES H. MURPHY, CHAIRMAN
MURPHY OIL CORPORATION

Mr. Chairman, thank you for the opportunity to express our views on the important subject of mergers and acquisitions in the energy industry. As I understand it the only bill actually being reviewed by this Committee is Senator Johnston's bill, S. 2362, which calls for a moratorium on mergers and acquisitions to afford the Congress time to study this important subject in greater detail. I do understand that the Committee will be happy to receive our views not only on the moratorium but on the broader question of whether and to what extent the Congress should intervene in the rationalization process which seems to be taking place in the energy industry. I will address the moratorium question first, then offer some comments on the merger question from the perspective of our Company, and conclude with some general observations as a citizen and taxpayer.

The overriding question on a moratorium is whether we need one at all. Only if we reach a consensus that one is needed do we need to address the technical questions, such as when it should commence, i.e. should it prohibit the Gulf-Socal and Mobil-Superior mergers, and whether it should prevent any merger or acquisition, no matter how small, as the proposed bill does.

On the broad issue of whether one is needed, it is often difficult to oppose a moratorium. After all, when an issue has aroused public attention such as this one has, what could be more reasonable than to ask for an allowance of time so that the matter could be studied and acted on in a considered deliberate way. The notion of a moratorium is alluring. The status quo is preserved, and theoretically no one is hurt while the Congress has an opportunity to do its job. Nevertheless, I declare myself at the outset as being opposed to a moratorium. One reason, which will become obvious later on, is because I am going to express my opposition to permanent legislation on this subject, but even laying that aside I am opposed to moratoria on principle. Life simply does not work that way. Would that it did, but it does not. The physician treating a critically ill patient, the general managing a major war, the businessman reacting to a competitive situation, all would like to make time stand still occasionally so they could carefully plot and plan their next moves. But it can't be done and it shouldn't be done. Time is the very essence of life and changes occurring with its passage are by nature inexorable. If we have a problem it should be dealt with appropriately and efficiently under the pressure of time, election year paralysis or no, and if we don't have a problem we should reach a consensus on that so we can get this out of the way and move on to the next problem. Too often in the past have we seen this country yield to the temptation of trying to take a snapshot of a situation, an industry, or a group of citizens (such as our blacks), and attempt to hold that snapshot as is while we decide what's to be done. There is then further temptation to prolong the scene represented by that snapshot and then there can only be one of two results, either of which is bad. One result is stagnation through continued extension of the moratorium, the other result is sudden wrenching change when the dynamics temporarily interrupted by the moratorium can no longer be resisted.

That then is my position in principle on moratorium - don't do it - it will only make you legislators indolent in addressing the problem if indeed there is a problem.

Next, I would like to offer some comments from the viewpoint of our own Company on the current spate of mergers that are contemplated in the energy industry. Much concern seems to be directed at the use of capital in mergers and acquisitions rather than devoting that capital to exploring for oil and gas. We see this as having perhaps some short term effects but not necessarily long term ones.

In the short term, much of the cash flow from the merged company will likely be used to repay debts incurred by the surviving party to the merger. Some, if not most, of this cash would have been used by the merged company for exploration and production expenditures and, therefore, exploration will decline due to these mergers. Our shareholders have a sizeable investment in the offshore contract drilling business and to the extent exploration suffers our contract drilling business suffers, but we also conduct an active exploration program and the decline in exploration activities should result in lower exploration costs, that is, lower seismic expenses, lower lease acquisition costs, etc. This should make exploration more attractive than it otherwise would have been. We believe however that all this will prove to be a short term aberration. If the system works right, the more attractive exploration opportunities will attract additional investment from other sources, some of which may come from former owners of the Gulfs, Gettys, and Superiors.

Neither are we unduly concerned at this point with a tendency of these mergers to concentrate market share in the downstream (refining/marketing) end of the business. For many years we have competed successfully in areas where one of our competitors had from 10% to 20% of the market and we feel comfortable that the dynamics of competition and the present array of anti-combine laws and regulations will keep this potential problem from getting out of hand.

In summary, then, we do not feel threatened by recent mergers even if all are ultimately consummated and, therefore, shun the need of restrictions on shareholders of other companies while the problem is studied in more depth. Moratorium on mergers for any extended time period seems to us to be such a restriction.

Should our views not be accepted and some legislation containing a moratorium become law, we have some problems with the drafting of this specific legislation. We are in other businesses besides oil and gas. Our investment in contract drilling has already been mentioned and, in addition, we are quite extensively involved in the farm and timber business. As the bill is now written we could not acquire a small timber company during the next six months without forever forfeiting our right to own new federal leases. If this is the intended result of the proposed legislation, it seems to us unnecessarily manipulative. We, therefore, would request the committee to consider limiting the penalties for mergers during the moratorium to two "substantial energy reserve holders".

We have no merger of any kind in mind, therefore, our objection to the proposed legislation is at the moment an objection in principle. It is difficult to foresee the future, however, and if the moratorium should exist for an extended period some opportunity might present itself which could not be pursued if this bill becomes law. Our shareholders, in that event, would be penalized for no good reason that we can discern.

Finally, not necessarily from the perspective of our company, but simply as citizens and taxpayers we suggest that the following points should be carefully considered by the Committee before it recommends enacting any restrictions.

1. Inhibiting mergers can lead to lethargy and even stagnation. In large public companies with widely dispersed shareholdings there won't be any way to oust an inefficient management. Stockholder apathy will increase as the market for their shares is further restricted.
2. The merger route can be a way of recycling capital to more efficient use. The Gulf shareholders stand to collect some $13 billion. If they believe that money can be

efficiently spent in exploring for oil and gas they will reinvest in that effort. If on the other hand they think that money can be more attractively used by the Government as part of the national debt, or by the steel companies to rebuild their outdated plants, that's where it will go.

3. The system we have in place does have some faults but they can be addressed within the framework of that system. The Sherman and Clayton Acts exist to prevent creation of monopolies in any line of business. Use them, and use them in a consistent fashion. Don't single out the oil industry for special treatment.

4. We would concede that there are flaws in the present system. One is that which allows an entrenched management to purchase its continued employment by buying out at a premium a dissident minority stockholder with assets belonging to all the stockholders. Another is in the two tier takeover which permits a

raider to acquire the first tranche of a target company's stock for cash at an attractive price, but then squeeze out the remaining stockholders with something other than cash. But, you already have the securities laws administered by the S.E.C. in place to guard stockholders' rights so we feel you should let those problems be addressed in the context of securities regulation rather than energy resources management.

5. If it is to be our national policy to force more investment in domestic oil and gas exploration, don't do it by stagnation by freezing the existing companies into a pattern of having nothing else to do with their assets - do it by removing the existing impediments to oil and gas exploration - cut back the excise on oil, misnamed a windfall profits tax, unshackle natural gas, continue open lease sales, and ease up on the restrictions on exploring frontier areas. This would not only stimulate existing competitors, but attract new ones.

STATEMENT OF JON REX JONES, PRESIDENT, JONES EXPLORATION CO., AND PRESIDENT, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

Mr. **Jones**. My name is Jon Rex Jones. I am an independent oil and natural gas producer from Houston, TX. I am here today appearing as president of the Independent Petroleum Association of America. We represent some 15,000 independent oil and gas producers in the United States. Mr. Chairman, we have submitted a formal transcript and I would like to summarize that for you at this time, if I may.

The recent wave of mergers and acquisitions in the oil industry which are the subject of these hearings has actually very little direct effect on the independent oil and gas producers in the United States. However, on general principle, we oppose any antimerger legislation that interferes with the free play of market forces in America. Also, we see indirect results of this legislation that could be devastating to an already troubled industry of which we are a major part.

Now, the media has reported that there is a major concern of the merger moratorium advocates upon the negative effects the mergers will have on exploration and development. I would suggest to those that are so concerned that if they want to find some real disincentives, they can examine the tax changes and Government actions that have impacted our industry in recent years.

Mr. Chairman, in our formal document, we have presented 12 of those disincentives and I would like to lift out of those 12 just 6 or 7. Some of them have been mentioned today, but I would like to highlight my remarks to those six or seven disincentives.

The first was in 1969, the adoption of the Tax Reform Act. This reduced depletion by 20 percent. The reason it had such an impact on our industry was not just that act itself but the fact that it followed 10 years when the price of oil and gas was actually flat in America and we continued to see inflation during that period of time.

In 1971, the imposition of crude oil price controls at the wellhead.

In 1975, the repeal of percentage depletion on 80 percent of the reserves in America and the extension of crude oil price controls at the wellhead for an additional 49.

In 1976, there was another Tax Reform Act. This time it put a punitive tax on cash expenditures by domestic oil and gas producers for intangible drilling costs.

In 1978, the adoption of the Natural Gas Policy Act which for the first time put price controls on intrastate gas prices and at the same time gave us an extremely complex regulatory system in which we found that natural gas was the only commodity in America with prices set on it for a ceiling price by the Federal Government.

In 1980, the adoption of the Crude Oil Windfall Profit Tax on domestically produced but not foreign produced oil. And we found this to be another additional extremely complex regulatory requirement that was not a tax on profits at all. It was an excise tax on crude oil.

In 1982, and my final remark on this item, is we had a congressionally mandated prohibition on leasing of significant portions of public lands that many independents and majors alike had designs on developing.

Now, in addition to these several threats on our industry that I have enumerated, there have been constant threats that we have had to overcome that never came actually into law, but the fact that they were threats on our industry at times were more burdensome than the actual law itself that was ultimately passed.

Moving on to another item now, why do mergers occur and why do companies have to sell out? Mergers, I think, have occurred and they are not a new phenomenon, just as a part of the economic cycle. We see businesses going down and coming up and I think it is an effort by many of the major companies to become more efficient.

Independents have been especially hard hit, however, during these down times, because so much of our capital comes from borrowed sources, as Mr. Pickens pointed out, and we do not have the old reserves to fall back on during these troubled times to bail us out. I would hate to see what would happen to the independent segment of our industry if our producers when facing chapter 11 possibilities could not look toward a larger, stronger company to buy them out, to bail them out of the problems that occasionally they find themselves in.

Another item in regard to this, I believe that if you took the major companies out of the marketplace, you would see the value of our reserves go down and, therefore, our ability to borrow money and establish capital would go down greatly and we would be hurt by that action as well. That is what I was referring to a moment ago when I said we are hurt by the indirect effect of anti-merger legislation.

Those are my several categories then.

What effect do mergers have on exploration? I think that is a topic today that a lot of people have addressed and we look at it with the drilling rig count again, and we have charted the drilling rig count since World War II. Looking at that chart of the actual rigs running, we cannot find any indication, even in times of intense merger activity, where there is an anomaly created negatively by mergers.

In fact, all of the anomalies that are on the negative side are caused by bad legislation. Anomalies on the positive side, which give us incentives to drill, are usually caused by price increases for our products.

Mergers do not really have any effect in the final analysis on independents. We drill about 90 percent of all wells in America, 90 percent of the wildcats. As you know, we drill 85 percent of all wells and find 56 percent of the reserves. So if the mergers do allow the major companies to become more efficient and we are allowed to explore as we have in the past, drilling 90 percent of the wildcat wells, and perhaps working together we can find energy for America.

That leads us then to the question of why do people drill? What is the parameter that causes independents and majors alike to say, yes, we want to go forward with this program; we want to drill this particular wildcat well or enter into this large venture in some remote area? Geology, technology, economics, and Government policy are those items which cause us to drill.

And I would like to tell a brief story as to how these four items impact on a company like ours. About 10 years ago, we decided to go out into western Colorado where tight sands can produce for our country reserves in the number of 250 trillion cubic feet of reserves. That would be about a 15-year supply, if we could release those gas supplies from those tight sands, and we decided to be a part of that play about 10 years ago and we developed the geology, the first element.

During this 10-year period of time that has just elapsed, we have developed the technology where we could extract the gas from those tight sands, but then in the last 2 years economics fell against us and it fell apart on us about 2 years ago. We found that at $3 a thousand cubic feet for that gas that it was not commercial for us and after drilling 25 wells, we had to temporarily abandon that project.

That brings us to the last element which is Government policy. I believe that the Government policy that I pointed out that has been a disincentive to our industry if put in reverse could mean the difference between our company going back to western Colorado and being a part of the developing of this 250 trillion cubic feet of gas supply.

I believe that it is obvious that as far as energy security is concerned, development of domestic reserves such as the 250 trillion I have mentioned, will ensure the energy security of America and offer the best protection that we could have from insecure foreign oil.

What is our domestic energy policy then as far as developing more energy security is concerned? Whether it is written or whether it is oral or whether it is just conventional wisdom, I believe that our energy policy is that in between the time of the fossil fuel era of the seventies and the exotic fuel era of the 21st century, the domestic industry is called upon to bridge that gap. It concerns me when I look and see that nothing is being done about exotics right now. In fact, their bus has been put in reverse.

When I look at our rig count in America operating at less than half capacity, I am greatly concerned with what this means for the future, especially this era between now and the time whenever it is going to be that these exotic fuels come onstream. So the question is then, will antimerger legislation find 1 more cubic foot of gas? Will it find 1 more barrel of oil, and will it do anything to bridge the gap during the perilous time that I am talking about?

Our opinion is the answer is a firm no. And what does this tell us about our energy security in this pending legislation? I think it tells us that we do not need this legislation and I think what it does tell us is we need the incentives that we have lost to be restored to the domestic oil and gas producer in America.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Jones follows:]

STATEMENT OF

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

BY
JON REX JONES
BEFORE THE
SENATE COMMITTEE ON ENERGY
SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
HEARINGS ON OIL COMPANY MERGERS
April 10, 1984

Statement of Jon Rex Jones, President
Independent Petroleum Association of America
Before the Senate Committee on Energy
Subcommittee on Energy and Mineral Resources
April 10, 1984

Mr. Chairman:

My name is Jon Rex Jones and I am an independent oil and natural gas producer from Houston, Texas appearing here as President of the Independent Petroleum Association of America representing some 15,000 independent explorer/producers. The recent wave of mergers and acquisitions in the oil industry which are the subject of these hearings has little direct effect on the majority of independent producers represented by IPAA. However, on general principle, we oppose any anti-merger legislation that interferes with the free play of market forces. Furthermore, it is dangerous for the government to establish such a precedent that could be used in the future to justify other far-reaching economic intervention.

I. OVERVIEW

Mr. Chairman, at the outset I would like to address the question of the impact of merger activity on domestic petroleum exploration and development. The media has reported this as a major concern of merger moratorium advocates. I would suggest to those so concerned that they will find real exploration and development disincentives if they will examine discriminatory tax changes of recent years and counter-productive regulatory policies. It was those actions, not recent mergers, which contributed to the 18% drop in gas well drilling in 1983 alone.

In 1969, the arbitrary reduction in the statutory depletion rate for oil and gas -- singled out from among more than 100 affected extractive industries -- was followed in 1970 and 1971 by the two largest annual declines in U.S. petroleum exploration history. Since then, additional disincentives have resulted from five more negative tax changes for domestic oil and gas, capped by the infamous "windfall profit" tax in 1980. Since 1954, the domestic oil industry has been the target of at least twelve significant governmental interventions which have seriously hampered domestic exploration/development activity. I suggest that if Congress wishes to stimulate exploration it could begin by reducing govern- ment intervention in the energy industry. By contrast, we can find no historical evidence during periods of intense merger activities that this has caused any measurable change in exploration/development activity. I'll discuss these issues in more detail later.

II. PRESENT ENERGY POSTURE

While imposing a merger moratorium would accomplish nothing positive toward improving our energy security, it does provide a smoke screen which obscures the real issues of concern not only to this Committee, but all members of Congress but, indeed, all Americans. This nation is in a perilous state of complacency about our energy posture. Almost daily, our consumption of energy, and particularly oil, is increasing at the same time that our domestic production is declining. Consequently, our reliance on imported oil is rising at a time when the instability of the Middle East is growing and the threat of a world wide disruption of oil supplies becomes greater. Our balance of trade deficit has grown to a new record and last month was $10 billion. The largest item in this deficit is the cost of imported oil which now averages $160 million per day or $60 billion per year. Instead of worrying about imposing a moratorium on oil mergers which will do nothing to improve domestic exploration-production activity, the nation would be better served if Congress focused attention on the specific causes of our current decline in exploration activity. The causes are many and varied but there are a few which are of overriding importance. These include:

1) the declining real value of crude oil and natural gas;
2) the increasing tax burden of domestic oil producers;
3) the market chaos afflicting natural gas under overkill regulation;
4) an outdated set of laws convering production, transportation and sales of natural gas;
5) governmental restraint of access to good drilling prospects on federal lands, on-shore and off-shore;
6) the escalating burden resulting from numerous regulatory initiatives by the Internal Revenue Service, Dept. of Interior, EPA, OSHA, etc.

While the mergers, which are the present focus of attention, should sound a clear alarm about our declining reserves/production ratio, such mergers are not the cause of the decline.

Annual additions to reserves are very erratic and may be either up or down in any given year. However, the trend of reserve additions is directly related to the level of exploration and drilling activity which, in turn, is directly related to the price of oil and gas at the wellhead. In the period from the end of World War II until the mid-1970's, each ten cent change in the per barrel composite price of domestic oil and gas was accompanied by a change of about $120 million in expenditures for exploration and development. That ratio applied equally to increases and decreases in prices and expenditures. In the mid-1970's, as the price began to escalate more rapidly, the ratio of expenditures to prices (contrary to what one might have believed from press accounts) increased significantly as producers and investors alike, responded vigorously to the improved economics in the oil industry. Conversely, as experience predicted, when the composite wellhead price of oil and gas in real terms peaked in 1981 and declined thereafter, the level of exploration and development expenditures also peaked in 1981 and has declined sharply since.

Another factor which has great impact on the level of exploration and development activity, is government intervention in the energy industry. Such intervention is manifested in many forms. For example:

1954: Supreme Court decision requiring federal regulation of wellhead natural gas prices (not implemented by FPC until 1957);

1966: Suspension of oil and gas leasing on federal lands beginning a policy of denying access to potential domestic petroleum supplies which has continued in one form or another to the present time;

1969: Adoption of the Tax Reform Act, reducing by 20% the statutory rate of percentage depletion for oil and gas;

1970: Passage of the National Environmental Policy Act, initiating a decade of frustration in the effort to drill off-shore, site refineries, build pipelines, stimulate coal consumption and develop nuclear power;

1971: Imposition of crude oil price controls at the wellhead;

1975: Repeal of percentage depletion for about 80% of U.S. oil and natural gas production and extension of crude oil price controls for an additional 40 months;

1976: Congress adopts another Tax Reform Act, retroactively imposing a punitive tax on cash expenditures by domestic oil and gas producers for intangible drilling costs;

1977: Department of Interior retroactively doubles rental fees on most oil and gas leases in federal onshore areas;

1978: Adoption of the Natural Gas Policy Act extending wellhead price controls to the intrastate market and imposing on natural gas producers an extremely complex regulatory system;

1980: Adoption of the Crude Oil Windfall Profit Tax imposing an excise tax on domestically produced -- but not foreign produced -- crude oil and subjecting producers to an additional extremely complex regulatory requirement;

1981: Applicable rate of percentage depletion begins a phased 30% reduction over a four-year period, sharply reducing cash flows available for exploration and development expenditures;

1982: Congressionally mandated prohibition of leasing on significant portions of public lands onshore.

During the past two years, domestic oil and gas producers have been subjected to the constant threat of a further extension of natural gas price controls, the imposition of a so-called Windfall Profit Tax on natural gas and further erosion of the traditional tax incentives which have been so important for attracting investment capital for exploration-development activities. It is such factors as these to which Congress should be giving its attention.

III. REASONS FOR MERGERS

It is perhaps significant that several of the companies most prominently involved in merger activity, Socal, Texaco and Mobil, were three of the four domestic companies comprising the ARAMCO consortium responsible for development of a significant portion of presently producing reserves in the Middle East. If these companies, which have better access to Middle East crude oil production and more experience with the costs and availability (or unavailability) of such production on an uninterrupted basis, are going to such considerable lengths to improve their domestic reserve position, we all have more cause for concern about our growing import dependency.

Oil mergers, designated a problematic issue by some in Congress and the media, in actuality are only a consequence of shifting economic tides affecting the petroleum industry as a whole. In point of fact, these mergers and acquisitions are not a new phenomenon but rather an historical outcome of downturns in the macroeconomic cycle as well as corporate growth in general.

As such, there is no evidence that consolidation increases concentration levels or decreases exploration activity. Present antitrust laws are therefore sufficient and do not require a supplemental ban on mergers. Furthermore, it cannot be shown that the present tax code treats property acquisition in a merger any more favorably than other types of investments. Each of these points will be discussed in turn as they relate to the independent oil producer.

Any government policy imposing a discriminatory moratorium on corporate petroleum mergers would interfere significantly with our free market economy. The petroleum industry today is undergoing a natural restructuring process in response to changing market forces such as the worldwide surplus, declining demand and prices. Consolidation is one viable option still open to firms grappling with business pressures such as declining reserves and the shifting balance of economic power away from U.S. firms. Another problem is that fewer investors are interested because crude oil discovery and production yield a lower rate of return today given the high finding costs and ever-present threat of new taxation.

A moratorium on oil mergers will do nothing to alleviate these pressures but rather will foreclose one important means of confronting them. In general, mergers reduce joint average costs of the consolidated operations relative to each company's cost level before the merger. Therefore, a ban on mergers will preclude the realization of these economic benefits which in turn will ultimately yield an adverse impact on the cost structures and competitive positions of regulated industries. Of course eventually, the misallocation of economic resources leads to an increase in costs to consumers.

In purely economic terms, capital markets act to allocate resources efficiently in response to price signals. In this way, profit maximization is ultimately achieved. Ideally, it is the capital market itself which dictates when and where structural changes should occur within an industry. For instance, corporate acquisitions are one of the primary methods by which a competitive market system reallocates resources in order to increase efficiency through the infusion of new capital and management.

Some independent companies have been particularly hard hit by the depressed oil market to such an extent that eventually mergers may be their only answer. During the industry expansion from 1978 to 1981, independents amassed considerable debt. Then when oil and gas prices fell, they were disproportionately affected because their heavy debt load exacerbated the problem. Many independents have become so highly leveraged in the past few years that their cash flow positions have been seriously threatened to the point of bankruptcy. Left unrestrained, the invisible hand of the free market will lead to the consolidation of complementary firms, solving the problems of cash flow as well as declining oil and gas reserves.

A government ban on mergers and acquisitions would prohibit industrial restructuring that could salvage many independent companies nearing Chapter 11 proceedings. Moreover, it would be a violation of their economic right to own, sell, exchange or purchase property and to run a business accordingly. If a comprehensive anti-merger law were enacted, America would witness a substantial flight of capital away from the controlled industry and instead toward investment opportunites where businesses can control their own transactions and stock values.

IV. EFFECT ON EXPLORATION AND DEVELOPMENT ACTIVITY

One of the principal points of debate regarding pending mergers has been their impact on domestic exploration. Some fear that exploration and production budgets will be cut as a result of the tremendous debt incurred in the financial takeovers. In actuality, the level of exploratory drilling is determined by drilling costs in relation to oil prices and available capital. Since most of the easily-found domestic oil reserves already have been tapped, additional reserves are costly to locate and produce. Given the current price of oil, today's level of exploration activity is all that is economically feasible in this surplus market.

Taking into consideration the other side of the exploration equation, drilling costs in the U.S have declined by about one-fourth since 1981. Furthermore, a substantial part of the major oil companies' budgets include large expenditures for offshore leases, bonuses and royalties. However with the cutback in federal offshore lease sales, plus extended delays caused by problems obtaining permits and litigation fostered by opponents of energy resource development, a part of these outlays will drop out of budgeted expenditures. These and many other such factors prove that projected expenditures are not a clear indicator of drilling activity.

No concrete evidence exists to substantiate that corporate acquisitions yield any sustained impact on exploration activity. The merged companies need new oil reserves over the long run just as they did operating separately. In fact, legislation that prevents the marketplace from reflecting the true value of oil reserves is far more likely to inhibit exploration activity. This can be seen by tracing how drilling programs have been impacted dramatically by political and economic factors such as the repeal of percentage depletion and the adoption of negative tax legislation.

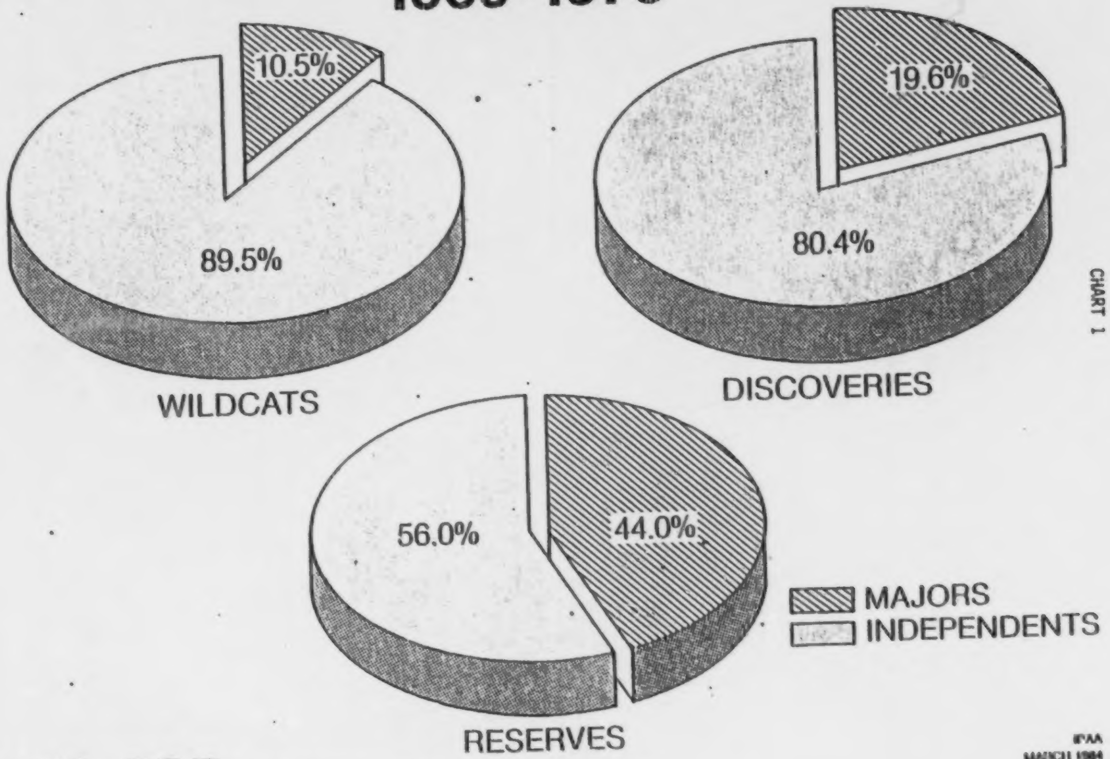
Since World War II, the multiplicity of efforts by independent, non-integrated companies has accounted for about 90 percent of U.S. exploratory drilling ventures. In addition, independents find 80 percent of significant new fields and over half of the total new reserves found. The share of exploration by independents has been affected only marginally by changing economic conditions in the petroleum industry.(Chart 1) There has been no perceptible change in the independents' share of exploration activity during cyclical downturns of the 1950's and 1960's which were marked by restructuring through consolidation and acquisitions. Moreover, there has been no lasting effect on total exploration by the industry as a whole.

In terms of production activity, the average daily output of independent operators over the years has remained relatively constant. However, as a percentage of total domestic production, the independents' share has increased significantly since 1969. The major oil companies, on the other hand, have seen their average daily production decline continuously except for the addition of the Alaskan North Slope.(Chart 2) Therefore, merger activity over the period has not increased the concentration of crude oil production in the hands of a few large companies and, further, it is not logical to assume that mergers will do so now.

The Federal Trade Commission has vigilantly tracked the competitive environment of the U.S. petroleum industry over the years. The most recent of their studies concluded that no evidence can be found supporting anti-competitive behavior in the oil industry. All things considered, existing antitrust review processes are fully adequate to deal with any aspects of a merger that might have possible monopolistic tendencies. In fact, the most significant regulation of business conduct imposed by the Clayton Act is that affecting mergers; its Section 7 is even more stringent than any implied by the Sherman Act.

CHART 1

ROLE OF INDEPENDENTS
1969-1978

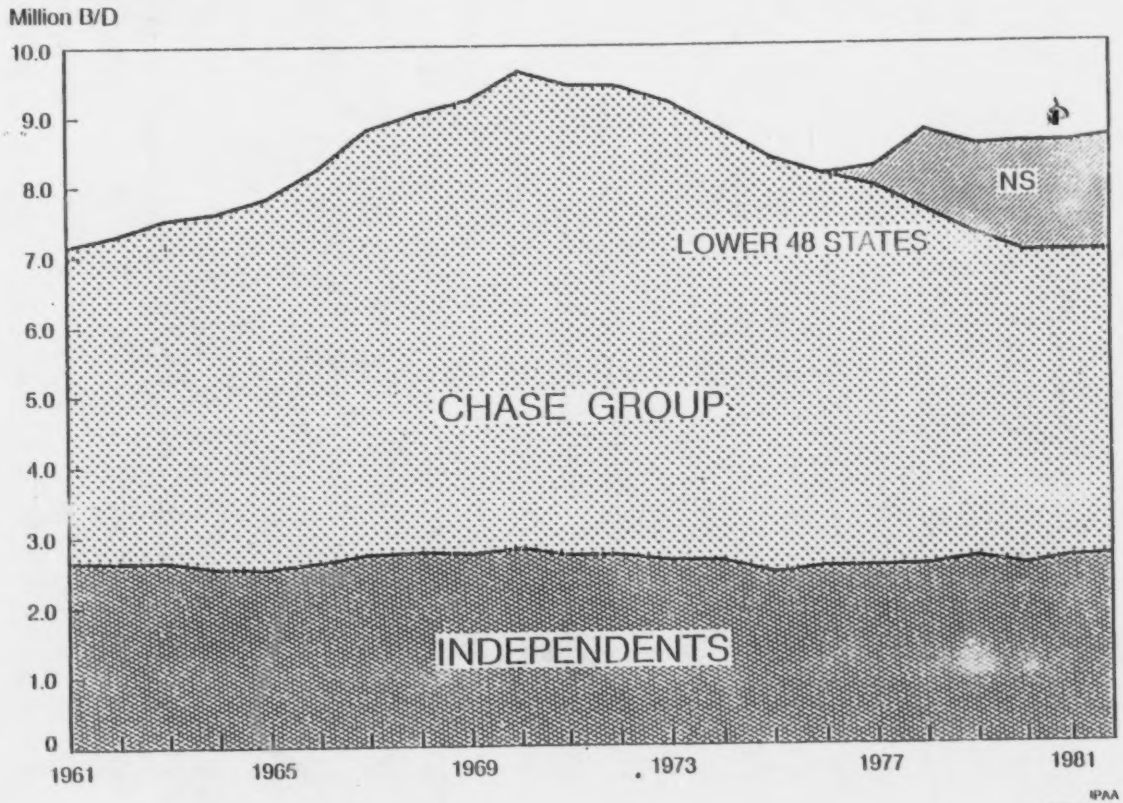


IPAA
MARCH 1984

Source: U.S. Geological Survey · Circ. 860 - 1981
These USGS estimates do not include potentially large supplies from Heavy oil,
tar sands, coal gas, geopressured reservoirs and Gas hydrates

CHART 2

U.S. CRUDE OIL PRODUCTION



IPAA
MARCH 1984

Thus, a clear line of judicial interpretation has emerged that supports a maximum possible deterrent to anti-competitive merger activity. However, current merger moratorium proposals not only appear to be based on issues far removed from traditional antitrust concerns, but also preclude consideration of individual acquisitions on a case-by-case basis.

One of the results of America's antitrust laws has been the spinning off of assets by merging companies in market areas where concentration levels might possibly present a problem. This divestiture, either voluntarily or as a result of an FTC order, has yielded a serendipitous outcome for many independent companies who can acquire pipelines, refineries, terminals and service stations at reasonable terms with long-run supply contracts.

In addition, the major oil companies have a tendency to acquire more new acreage than needed for immediate drilling programs, thereby tying up leases that could be used for exploration. Once they have merged with another company, majors generally farm out more of their acreage to independents who are known for drilling more aggressively. Therefore, the net effect of merger activity often is the strengthening of competitive conditions in the petroleum industry, particularly in exploration activity.

V. THE ROLE OF GOVERNMENT

The energy future of America will be secure or insecure based on public and political understanding of two very simple facts: (1) nobody is excluded from the oil business, but (2) nobody has to be in the oil business. This country developed and maintained energy supplies in excess of its needs for more than a century. This did not occur because providence favored America over other nations with petroleum deposits. It did not happen because we -- as a people -- possessed a keener nose for oil and gas than others. It happened because only in America individuals are permitted rights which are the essence of private enterprise, i.e., the rights to own, to sell, to buy, to explore and to produce petroleum fuels. In every other nation, those rights are tightly controlled by governments.

Now these unique rights existing only in America guarantee nothing to anyone. In the cumulative experiences of tens of thousands of explorers, successes have ranged from abject failure to extraordinary discoveries. It has been the possibility of extraordinary success that has lured so many for so long to the search for oil and gas. Should that possibility ever be lost or denied, our energy and economic futures will be foredoomed.

In her great oil book "The Greatest Gamblers,"[1] Ruth Sheldon Knowles observed that "Oil is found in abundance only if a great many people are looking for it all at once in all sorts of unlikely places." In America, this is a literal truth because this land has none of the great oilfields typical of the Persian Gulf. Instead, we achieved energy supremacy in the first 60 years of this century because tens of thousands of explorers found tens of thousands of relatively small oil and gas deposits across the 3,000 mile expanse of the continent.

The energy challenge in the rest of this century will be to keep enough curious explorers committed to the search for petroleum fuels. Our task is to see that enough oil and gas is available to adequately fuel our economy and provide for the national security in the transitional period of the next 30 years while alternative energy systems evolve. Oil and natural gas may not dominate the energy market a half century from now, but they will still be very much in the picture.

There are four very important elements that will control the level of the search, the number of willing participants, and indeed whether our energy future in America turns out to be bright or dark. These essential elements are geology, technology, economics and government policy. All of these elements except the last, government policy, are obvious to many -- and though many would leave government policy out of the equation, it is now and will remain the most important consideration in confronting our energy future.

---

[1] The Greatest Gamblers: The Epic of American Oil Exploration, 2nd Edition, 1978, University of Oklahoma Press.

Only one of these elements, geology, is beyond the influence of man. We do, however, possess the intellect to assess geologic prospects for oil, natural gas and other minerals. Even the most conservative estimates of petroleum fuels likely to be found in our unexplored or superficially explored sedimentary basins indicate enough of these fuels to last well into the next century. So the lack of an oil and gas resource base will not be a limiting factor for the next generation and beyond.

Likewise, there is every reason for absolute confidence in the technological skills of the domestic petroleum industry. Time and again in the 1960s and 1970s, persons having no experience and therefore no faith in petroleum technology, argued essentially that we were running out of oil and gas; that even if we had any left we couldn't build the rigs, manufacture the pipe and train the manpower to drill enough wells. Their answer to the energy problem was simply to increase government regulations so as to divide an inevitably dwindling energy supply among the people at the lowest possible cost.

The performance of the domestic industry, led by independent producers resulted in increasing total drilling from 27,000 wells to 88,000 wells in just nine years between 1973 and 1982. The technological skills and innovations of the domestic petroleum industry are the envy of most countries, and are in demand by oil-finders in most corners of the earth. So adequacy or responsiveness of technology need never be a limiting factor in the outlook for the development and production of energy resources.

The two remaining factors -- economics and government policy -- will be the most important influences for the future. They will control the climate for investment, and, in the end, whether we succeed or fail in providing needed resources. Economics and government policy involve the most uncertainty because explorers and investors are vulnerable to both, and have little influence over either. In fact, the economic climate for energy development is controlled more by government policy structured by politicians than by any other influence. And what government will do that may either induce or constrict energy investment and production is the "X-factor" in any outlook -- the unknown quantity.

In 1979, the widely known and respected geologist, Michel T. Halbouty, said, "There is no energy shortage anywhere on earth that has not been caused by government." I believe that is an almost literal truth. Many of the third world countries whose leaders condemn OPEC for its oil pricing have the means of reducing or removing their OPEC dependence by developing their own resources. Who is keeping them from it? In many instances it is simply a lack of imagination reflected in a paralysis of government indecision and inaction.

But government action or lack of action negatively affecting energy development is by no means limited to backward or inexperienced countries. Here in what we all would claim to be the land of enlightenment, government policies alone caused the virtual dismantling of the domestic petroleum producing industry in a 17-year period commencing in 1956. In that 17 years, drilling dropped from 58,000 to 27,000 wells. Sixty percent of our drilling rigs were stacked and cannibalized. More than half of the independent oil and gas producers -- some 10,000 -- gave up or were forced out and went into other enterprises. Remember: Nobody has to be in the oil business.

Now, the federal government didn't just decide one morning that "we are going to put some brakes on the oil industry and get rid of about half of the independent producers." What it did decide deliberately was to pursue a policy of holding oil and gas prices progressively below replacement costs to "benefit the consumer." The effect was the same. Looking out for the consumer was the political goal -- but the practical results were to raise our oil import dependence to unacceptable levels, and to so weaken U.S. energy producing capability as to enable OPEC to dictate world oil prices. The policy brought us our first gasoline lines in 1973-74, and our second in 1979. Having been a closeup witness to all this, I feel that the political gains -- if any -- made by those who insisted on "protecting" the consumer in such a manner rank with the most ill-gotten gains in history.

How much have we learned from this? Very little. Even now there are important political groups in Washington who are strongly persuaded that rigid control of the petroleum industry is in the public interest. There are others in the political community just as persuaded that private industry should be denied the rewards of its occasional successes in finding oil and natural gas. The strategy of these elements is to claim those rewards for the federal coffers, by confiscatory taxation, so they can be redistributed to people who have not found any oil or gas.

Circumstances today are ominously similar to those of the late 1960's. Economic conditions generally are good but the petroleum industry continues in a slump. Oil and natural gas prices are declining and consumption is increasing. The press and T.V. commentators repeatedly remind the public that OPEC is an economic basket case and we are in the midst of a long-term world wide oil glut. But domestic production is declining and imports are increasing. Some politicians, most notably certain presidential candidates, are pointedly making the petroleum industry a whipping boy and scapegoat for those few economic conditions which are not improving and many in Congress are again calling for greater government intervention in domestic energy activity.

Many different legislative schemes have been proposed, from a one-year merger ban among the top 50 oil companies, or the top 20, to a six-month moratorium with various retroactive provisions. The entire issue of anti-merger legislation has evolved into a highly arbitrary concept. Where would the moratorium end? Even if it initially applied only to large companies, it would not be long before intermediate-size firms and then smaller independents were affected. Even more likely is the spread of anti-merger legislation to other industries. Once the precedent has been established, government has a natural tendency to keep expanding, layer by layer, one law on top of another, ad infinitum.

The domestic petroleum industry faces a multibillion dollar challenge, if not obligation, to find sufficient oil and gas supplies to provide for America's future energy security. With oil supplies in the Middle East becoming increasingly unreliable as political tension mounts, it is even more important to maintain the viability of U.S. petroleum companies.

In a competitive economy, the free market system undergoes its own self-correcting adjustments through capital flows, mergers and acquisitions resulting in a more efficient allocation of resources. These processes have occurred throughout industrial history with resulting gains in economic efficiency. They should be allowed to continue their normal course uninhibited by government policy. Within appropriate antitrust guidelines, any interference with the economic rights of business consolidation goes against America's entire free enterprise philosophy.

The actions of this Committee and Congress toward either stifling initiative or providing incentives for petroleum exploration-development in a positive economic/regulatory climate will play a vital role in determining our energy future. In closing, let me repeat something I stated earlier: the energy future of America literally will be secure or insecure based on public and political understanding of two very simple facts: (1) nobody is excluded from the oil business, but (2) nobody has to be in the oil business.

Independent Petroleum Association of America
April 10, 1984.

Senator **Warner**. That was a very concise statement. The subject of interest rates was raised by a couple of members of this committee. Would you like to comment on that? I posed the question to the previous panel. I am sure you heard the question. Is there a causal credible connection between fact and mergers in the upper trend at the present time?

Mr. **Jones**. We have looked at the circulation of money that happens when you have mergers and it is our feeling that the money that is paid to those stockholders has to go somewhere and it would be our opinion it would circulate right back into the money flow, sir.

Senator **Warner**. Senator Nickles.

STATEMENT OF HON. DON NICKLES, A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator **Nickles**. Thank you, Mr. Chairman. I want to compliment you on the hearing. I apologize for the necessity of not being here. Possibly the cameras are not here because we have wrestled with this issue on the floor and we were successful in repealing it. I think that was the right thing to do. I would ask your indulgence to insert a statement in the record.

I have a couple of comments. I heard this panel. I did not have the pleasure of hearing Mr. Pickens, but I did listen to your presentation before the Judiciary Committee when this issue was very hot and we were in the process of debating the bills before the floor.

Mr. Pickens, as I remember, one of the strongest arguments you made was basic individual stockholders' rights to be able to either buy or sell stock. Is that correct?

Mr. **Pickens**. That is correct, Senator Nickles.

Senator **Nickles**. I would compliment you on that. A couple of mergers that I am familiar with deal with companies that I am pretty familiar with. One is the Getty Co. I did not particularly like in some respects Texaco's taking over Getty, but I still would have a real reluctance to pass a law that says that Gordon Getty or somebody else could not sell stock that they owned.

The same thing could apply to any number of emergencies. It seems to me like we in Congress, if we place a moratorium or a prohibition on an individual, prohibiting him from being able to sell his own stock or conversely prohibiting him from being able to buy stock as long as there is compliance with the antitrust regulations that we have before us, that we would really be infringing on a person's personal rights or their economic rights or their individual liberties.

I would hate to see Congress single out any industry, whether it be the oil industry or any other industry, for that particular prohibition. So I compliment you on raising that argument. I think some of the other arguments that have been raised by Mr. Murphy and Mr. Jones, concerning the effect of it on exploration, concerning the effect on credit, I would concur with your statements.

On the credit argument, that money does not disappear. Somebody is buying the stock; somebody is receiving that money; and that money would be directly recycled back into the markets.

Let me ask one question of Mr. Pickens or any of the panelists. Some individuals have made the statement, well, the Federal Government's present policy subsidizes mergers because whoever borrows that money has the luxury of being able to deduct that interest, therefore, the Federal Government is subsidizing these acquisitions, because that interest is deductible. Some would consider possibly introducing legislation that would disallow interest deductions used in mergers or acquisitions. Is there any comment on that type of legislation?

Mr. Pickens. Why? Why would anybody want to disallow something as healthy and let's just single out the Socal/Gulf deal. You are talking about here a deal that is going to put right into the U.S. economy $13.2 billion and $6.5 billion of that $13.2 is profit. Out of that profit over $2 billion in taxes will go to the Federal Government. And you are taking assets from weak hands and putting them into strong hands.

I cannot understand why anybody would want to stop it. We talk about having interest deductions. Well, we have interest deductions in every other industry. That is not anything unusual. And if the interest is collected some place else, there are taxes to be paid on that.

So I do not understand why we are trying to stop something that is as healthy as this is in the free enterprise system. It makes all of the sense in the world. I do not see an argument against it. Everybody is a winner, even Mr. Lee at Gulf Oil is a winner. He leaves with $20 million. So why do we want to stop it?

Senator Nickles. Is there any other response to that?

Mr. Jones. Senator Nickles, my comment on that would be that I do not view a stock sale from one company to another or a shareholder to a company any different than any other piece of business transaction in America. I cannot see why that would be singled out. It is a free trade and the free enterprise system would be tampered with in that regard.

Senator Nickles. I would concur with that, particularly as far as allowing the deductibility of interest. If we are going to allow other people—in the past I have borrowed money to acquire stock from various corporations. I would have a real problem singling out a particular industry and say you could not borrow in this industry but you could in any other industry. I think that would be a very poor economic policy.

Mr. Murphy, did you have something to say?

Mr. Murphy. Mr. Chairman, I would have nothing further to say, not because I do not have strong feelings, but because it has all been so well said here already.

Senator Nickles. Mr. Chairman, thank you. I apologize for the fact that I am right in the middle of an important hearing, one that is on an issue that is very much still alive and that is on the *Adesco* case and whether or not that should be overturned.

I am cochairing that hearing with Senator Hatfield, so if you will excuse me I must return to the hearing. I appreciate you holding this hearing, and also I compliment you on the witness list. Again, I stayed through the entire day of hearings before the Judiciary Committee and they were not able to bring up the number of experts like you have done today. I sympathize with you for the amount of time that will be involved, but also it does look like you are going to have a very complete and thorough hearing and I compliment you on that.

Senator **Warner**. I thank the Senator from Oklahoma for his remarks and we have availability this morning for all interested parties to participate and the record will remain open for any further questions that you care to provide.

[The prepared statement of Senator Nickles follows:]

Senator Nickles' Statement before the Senate Energy Committee Hearing on Oil Company Mergers April 10, 1984

Mr. Chairman, I appreciate your scheduling this hearing on mergers within the petroleum industry. This is a very complex subject with far-reaching consequences and therefore Congress is well advised to proceed slowly and do its homework before enacting legislation, if any indeed is found to be needed.

I will be brief this morning Mr. Chairman since I have already spoken on numerous occasions on the Senate floor as well as testifying before the Senate Judiciary Committee last month on this issue. However I do want to express several concerns this morning that I have about the current restructuring that this now occuring in this industry.

First I want it to be known that I do not particularly like the mergers which have occurred. As my colleagues well know several of the mergers these past few years involved previously independent Oklahoma companies. I would have much preferred that they remained independent. There have been some obviously adverse economic and employment effects in my state as a result of the mergers. So I am not a proponent in any way of mergers per se.

Secondly, I firmly believe that the whole idea of a moratorium on mergers, while Congress "takes a look," was and is the wrong way to proceed. I believe the Senate was right in defeating recent attempts to invoke such a cloud over this industry, or any industry. Such an intrusion into the marketplace was and is unwarranted and unwise.

Thirdly, I have not been convinced to date that such mergers divert money from exploration budgets of these companies. Nor have I been convinced by the argument that the borrowing to finance these mergers raises interest rates and substantially "dries up" capital in the credit market. Nor have I been persuaded that the anti-trust laws and their enforcement have failed to keep the marketplace competitive.

.Finally I want to say that I am open-minded on this issue and willing and desirous to learn. I am very pleased with the list of distinguished and qualified witnesses that are appearing before the Committee this morning. If we decide that legislation is necessary, then I want us to work carefully to insure that it is the right legislation. If none is necessary, then let us be satisfied to draft none.

Again Mr. Chairman I thank you for arranging this hearing. This is the best way to proceed. We are dealing with millions of individual shareholders and very elementary individual rights and therefore it is essential that we proceed cautiously.

Senator WARNER. Senator Hecht.

Senator HECHT. Thank you, Mr. Chairman. Mr. Pickens, I am a new freshman Senator here and one think that I am thinking while you are talking, the Attorney General has stated through Mr. Ginsburg earlier that they see no problem, the Antitrust Division has not stated a problem, the Treasury Department has stated they do not feel that money will be taken out of circulation, but only recycled. Why are you being painted in such a bad light when obviously you have acted properly in the free enterprise system?

Mr. PICKENS. I think the answer to that could very well be that, first, I believe, that once the deal is understood by the media that the bad light will change to one of favor on what we are doing, because it will be seen as protecting stockholders. I think the bad light comes from remarks by management of, the management of Gulf Oil, for example, or other managements that may feel threatened.

But I am amused when I heard said here a few minutes ago the talk about the speculators, that the speculators have taken over the company. Speculators to me, that is somebody that went out and put up some money and expected to make a profit. That is what a speculator is. That is what the free enterprise system is.

All of us, whether we are short-term or long-term speculators, that is exactly what we are. We put up our money and we are taking our chances. We expect to be rewarded if we gain.

I am also further amused when I hear the remarks that this would be a disaster. It would be a disaster for our company, speaking of Gulf Oil, if they went—if they were not allowed to do the Socal deal. What would happen then? Well, we would lose the company in a proxy fight. It would be a disaster. And do you know what we are saying here with those kind of statements? That is that stockholders are so stupid that they are going to vote for a disaster. Now, we thought that stockholders were smart enough to buy our stock, but we think they are stupid enough that they would not know who to vote for and consequently they would vote for somebody who was going to create a disaster for them.

Now, we put $1 billion into this deal. Do you think we are in here for a disaster? Well, of course we are not, nor is any other stockholder. The disaster for this company, Gulf Oil, is in liquidation. This company has been in liquidation for 12 years now. Incredible, but this company has an appraised value of $114 a share. The high was $53 when we bought our first stock. It was $27 today. It is going to be sold out at $80. We offered $65. That stock is not just a silly offer. That offer is still substantially above the all-time high for that company. And all the management could do for the stockholders in August 1983 was $37 and they were doing pretty good. They came up from $47 in the last 5 years.

This company, for them to sit here and say what are you up to, we are up to maximizing value for the stockholder. That is what we are after.

Senator HECHT. One last question. A little earlier I asked the panel of Government witnesses whether there were policy criteria that Congress ought to consider when we look at the oil mergers. The panel made no reply. Do you agree with this nonresponse?

Mr. PICKENS. I think this is a free enterprise system sorting out weak links in the chain. And I think it should be taken care of just exactly that way, just let it go ahead and happen. It will work its way out. The oil industry is strong. It has strong people in it. We have had a good record, but there are some things that need to be sorted out right now and they are being sorted out. So just leave us alone and we will get it sorted out.

Senator HECHT. Mr. Murphy, would you agree with that?

Mr. MURPHY. Yes, certainly, directionally I do. I will not miss this opportunity though to offer one opinion for low stock prices. Certainly, if a company is in liquidation, certainly if a company has weak management, and I will not comment on any particular management as being weak or strong, but the stock of that company is going to be depressed.

But there is another thing, too, for lower stock prices in oil companies and that is the market perception that in hard times by definition, we are not going to make much money, and the perception that in good times, this Congress and governments in other parts of the world too are going to syphon it off. So either way you go, there are not going to be huge profits in this business.

In addition to the factors that my friend Boone Pickens has established, or stated so articulately here, that is a major depressant on the share price of oil companies.

Senator HECHT. Mr. Jones, do you have anything to add to that?

Mr. JONES. Really, I do not have anything to add to the concrete answer that has been given, but I cannot miss this opportunity to say that I wish the energy and the insight that is going into all of these hearings regarding mergers and acquisitions could go into what is the problem with our industry today.

Senator HECHT. Do you want to elaborate on that?

Senator WARNER. I think, Senator, that opportunity has been given to Mr. Jones and he can supplement that for the record. I think unless you feel a strong urge to address that point, I think you have addressed it.

Mr. JONES. Yes, sir, you are right.

Senator WARNER. The use of the word "speculator" brings to mind those of us who are in the Senate races. I think there may be a speculative element to that.

Thank you very much, gentlemen.

We will have our next panel. The next panel will consist of James W. Heizer, executive director, Virginia Gasoline Retailers Association; and Jack Blum, general counsel, Independent Gasoline Marketers Council, Washington, DC.

Two of the panelists were advised this panel would convene at 12 noon. We will proceed with these two witnesses and provide the opportunity later for the others.

Mr. Heizer, we welcome you before this committee. You have been here before and your testimony is very valuable.

STATEMENT OF JAMES HEIZER, EXECUTIVE DIRECTOR, VIRGINIA GASOLINE RETAILERS ASSOCIATION, ON BEHALF OF THE SERVICE STATION DEALERS OF AMERICA

Mr. **Heizer**. Thank you, Mr. Chairman. I welcome the opportunity of appearing before the committee today to present testimony on behalf of Virginia Gasoline Retailers Association and Service Station Dealers of America, representing some 50,000.

When I was a youngster, Senator, I used to play with my brother and sisters a game of "Monopoly" and some 29 years ago, I was employed to become the executive director of the service station dealers organization in Virginia, and it seems that every since then, I have been involved in one of the most deadly games of "Monopoly" that the world could possibly imagine. Coming up now to the recent state of mergers to which the Service Station Dealers of America are opposed, we believe that this will lead to a generation of superoil companies in an area of diminishing competition 70 years ago, this Congress presided over the breakup of the Standard Oil trust in an effort to end a monopoly of the oil industry. This spawned the famous Seven Sisters. Today we are watching the process being reversed as some of the spun-off companies reamalgamate into combines that dwarf the original parent company. Our concern with the amalgamation of these major refiners is its effect on the price that motorists will pay for gasoline in the future and on the competition in the retail industry.

It is very likely that a $13 billion merger such as Socal/Gulf would eventually affect the $13 purchase of gasoline anywhere in the United States.

We are concerned about thousands upon thousands of retail marketers across the country. Will they remain as efficient, competitive outlets able to sell branded product with all related services to the millions of motorists who depend upon them? Or will they be sold for their real estate value in a quick grab for profit? Or will they be traded around like baseball cards? Will our domestic gasoline industry become a chain of company operated, automated, unattended, ghost stations as now exists in parts of Europe?

We have studied the FTC consent order in the Texaco-Getty merger. Nowhere in that 60-page document is there any mention of how the disposition of some 1,900 retail outlets will affect the business interests of the independent marketers, the dealers, and the jobbers who are involved, or how the services which they provide to their customers will be protected.

Rather, the disposition of stations is referred to in a manner similar to making transactions on the monopoly board. These are not pieces of plastic; these are independent businesses with real, live, breathing people affected. Businessmen who have spent a lifetime serving in their communities, at the very least, deserve the right to purchase their locations, which the companies are being forced to divest.

Instead we see 600 branded Getty dealers in the Northeast being turned over to a small, nondescript, unbranded, independent marketer, power test, which is being loaned the money to purchase them by Texaco. Many of these dealers are frustrated at being abandoned by Getty and outraged by Texaco's callous disregard of their interests.

In the near future, we will be filing comments with the FTC suggesting that the Texaco/Getty consent decree should include some additional provisions to protect the small businessmen and, in turn, consumers. This may be the case of trying to lock the barn after the horse is out. However, these points should be considered in the event of future mergers.

Every Texaco station should be able to buy motor fuel on the open market from the most competitive source. Texaco should sell to the existing Getty dealers their facilities at fair market value. Texaco should help dealers purchase their stations through loan guarantees or owner take-back financing. The same arrangement should be made for any Texaco dealers who would lose their locations as a result of merger or subsequent divestiture.

In all areas where the dealers are affected by the merger, Texaco must divest itself from company-operated service stations.

All Texaco and Getty wholsesale distributors should be allowed to sell motor fuel in all marketing areas, and that the wholesalers motor fuel purchases not be restricted by contract volume, and all wholesalers be allowed to sell to all branded or unbranded outlets.

In the past year, we have made a study of the retail market in several countries which share the same international oil companies as we do in the United States. In every case, these same refiners have achieved domination in the oil industry to where they now control the retail market and its prices in that country by simply eliminating competition.

For example, in Canada a concentration of power in the hands of six refiners enables them now to set the retail prices in more than 90 percent of the service stations in Canada. The former independent dealers are now commission agents.

In Australia, a railroad strike and a huge increase in automobile use last July saw these same companies simultaneously increase the price of their gasoline 25 cents per gallon overnight.

In every country special commissions are now working on recommendations to restore competition in their retail gasoline market. In most cases it is too late. Canada's Commission recently recommended that dealers who have been captive customers to their suppliers be allowed to buy product from any source and that the companies divest themselves of 50 percent of their retail outlets.

These countries are an example of what we can expect in the United States if the merger trend is allowed to continue. In a few years, we may be working as they are in Canada, Sweden, Japan, Australia, Britain, and Europe, to restore competition in the oil industry.

Now, I would like to also present to the chairman and to the committee a clipping which I brought along with me from the Oil Daily, dated March 15. A Reuters Financial News report headlined "Saudis, Kuwaitis Could Seek Some Gulf Assets." The opening paragraph says:

> Both Saudi Arabia and Kuwait are likely to be in the market for assets which will probably be sold off to win U.S. approval for a takeover of Gulf Corp., oil industry analysts in the Persian Gulf say.

Now, we have many Gulf dealers in Virginia, very few Chevron, not more than five or six. At this point the Gulf dealers in Virginia do not know whether they are going to still be Gulf; they don't know whether they are going to be Chevron; they do not know whether they are going to be flying the foreign flag of Kuwait or Saudi Arabia.

Senator **Warner**. Now, wait a minute. Let's hope not. I am certainly sympathetic. I will do what I can to assure the Service Station Dealers of America have the opportunity to hear from the oil companies the response to the inquiries that you have made. We will do what we can. Because as you said, they interface with the public.

Mr. **Heizer**. Well, we do realize that during the oil embargo, back in the seventies, if there should become foreign ownership of the downstream market and there should be an embargo again in the future and if those stations were controlled through Virginia and thorughout the Nation by one of the OPEC nations, it could certainly make those long lines at service stations become much, much longer.

[The prepared statement of Mr. Heizer follows:]

TESTIMONY ON BEHALF OF
SERVICE STATION DEALERS OF AMERICA
BEFORE THE
ENERGY AND MINERAL RESOURCES SUBCOMMITTEE
OF THE
SENATE ENERGY AND NATURAL RESOURCES COMMITTEE
ON
OIL COMPANY MERGERS

BY
JAMES HEIZER
EXECUTIVE DIRECTOR
VIRGINIA GASOLINE RETAILERS ASSOCIATION

APRIL 10, 1984

MR. CHAIRMAN, WE ARE OPPOSED TO THE SPATE OF MERGERS INVOLVING MAJOR OIL COMPANIES. ANYONE FAMILIAR WITH THE RETAIL GASOLINE MARKET, HERE AND ABROAD, KNOWS THAT THE FINAL IMPACT OF THE MERGERS WILL FOCUS IN ONE AREA -- THE RETAIL MARKET.

SEVENTY YEARS AGO, THIS CONGRESS PRESIDED OVER THE BREAKUP OF THE STANDARD OIL TRUST IN AN EFFORT TO END A MONOPOLY OF THE OIL INDUSTRY. THIS SPAWNED THE FAMOUS "SEVEN SISTERS".

TODAY WE ARE WATCHING THE PROCESS BEING REVERSED AS SOME OF THE SPUN-OFF COMPANIES REAMALGAMATE INTO COMBINES THAT DWARF THE ORIGINAL PARENT COMPANY.

WE ARE CONCERNED NOT ONLY BY THE WAY IN WHICH THESE HUGE COMPANIES ARE GOBBLING EACH OTHER UP, WE ALSO ARE CONCERNED BY THE WAY THEY HAVE BEEN SWALLOWING WHOLE CHAINS OF INDEPENDENT MARKETERS. AND WE ARE CONCERNED BY THE WAY THE MAJOR REFINERS HAVE BEEN DRIVING THEIR OWN WHOLESALE AND RETAIL DISTRIBUTORS OUT OF CERTAIN MARKETS SO THE COMPANIES CAN HAVE THOSE MARKETS FOR THEMSELVES.

WE ARE CONCERNED ABOUT THE FORGOTTEN PEOPLE OF THESE MULTI-BILLION DOLLAR MERGERS, THE FATE OF THOUSANDS OF RETAIL MARKETERS ACROSS THE COUNTRY. WILL THEY REMAIN AS EFFICIENT, COMPETITIVE OUTLETS ABLE TO SELL BRANDED PRODUCT, WITH ALL RELATED SERVICES TO MILLIONS OF MOTORISTS WHO DEPEND UPON THEM? OR WILL THEY BE SOLD FOR THEIR REAL ESTATE VALUE IN A QUICK GRAB FOR PROFIT? OR WILL THEY BE TRADED AROUND LIKE BASEBALL CARDS? WILL OUR DOMESTIC GASOLINE INDUSTRY BECOME A CHAIN OF COMPANY-OPERATED, AUTOMATED, UNATTENDED, GHOST STATIONS AS NOW EXISTS IN PARTS OF EUROPE?

WE HAVE STUDIED THE FTC CONSENT ORDER IN THE TEXACO-GETTY MERGER. NOWHERE IN THAT 60 PAGE DOCUMENT IS THERE ANY MENTION OF HOW THE DISPOSITION OF SOME 1,900 RETAIL OUTLETS, WILL EFFECT THE BUSINESS INTERESTS OF THE INDEPENDENT MARKETERS, (DEALERS AND JOBBERS) INVOLVED, OR HOW THE SERVICES WHICH THEY PROVIDE TO THEIR CUSTOMERS WILL BE PROTECTED.

THUS FAR, THE THOUSANDS OF INDEPENDENT MARKETERS AFFILIATED WITH THE OIL COMPANIES BEING ACQUIRED IN TODAY'S MERGERS, HAVE BEEN TREATED AS SURPLUS BAGGAGE, TO BE THROWN OVERBOARD IF THEY GET IN THE WAY OF CLOSING THE DEAL. WE URGE THIS COMMITTEE TO RECOGNIZE THAT THESE GASOLINE DEALERS AND JOBBERS ARE NOT PLASTIC PIECES ON A MONOPOLY BOARD. THEY ARE INDEPENDENT BUSINESSES, WITH REAL LIVE PEOPLE INVOLVED, WHO ARE TRYING TO MAKE A HONEST LIVING BY SERVING THEIR LOCAL COMMUNITIES. AT THE VERY LEAST, THEY SHOULD BE GIVEN THE FIRST OPTION TO PURCHASE THEIR LOCATIONS WHICH THE COMPANIES MUST DIVEST.

INSTEAD WE SEE 600 BRANDED GETTY DEALERS IN THE NORTHEAST, BEING TURNED OVER TO A SMALL, NONDESCRIPT, UNBRANDED INDEPENDENT MARKETER, POWER TEST, WHICH IS BEING LOANED THE MONEY TO PURCHASE THEM BY TEXACO. MANY OF THESE DEALERS ARE FRUSTRATED AT BEING ABANDONED BY GETTY AND OUTRAGED BY TEXACO'S CALLOUS DISREGARD OF THEIR INTERESTS.

ALREADY, WE ARE RECEIVING COMPLAINTS FROM SOME OF THESE GETTY DEALERS THAT THEIR 3-YEAR LEASES HAVE JUST BEEN REDUCED TO ONE YEAR. THAT SOME ARE NOW BEING THREATENED WITH TERMINATION IF THEY DO NOT SELL MORE GAS. WE ANTICIPATE MANY MORE.

IN THE NEAR FUTURE WE WILL BE FILING COMMENTS WITH THE FTC SUGGESTING THAT THE TEXACO-GETTY CONSENT DECREE SHOULD INCLUDE SOME ADDITIONAL PROVISIONS TO PROTECT THE SMALL BUSINESSMEN AND IN TURN CONSUMERS. THIS MAY BE THE CASE OF TRYING TO LOCK THE BARN AFTER THE HORSE IS OUT. HOWEVER, THESE POINTS SHOULD BE CONSIDERED IN THE EVENT OF FUTURE MERGERS.

IF THE TEXACO-GETTY MERGER IS ALLOWED TO GO AHEAD THROUGH, WE ARE ASKING THAT THE FTC AND THIS COMMITTEE CONSIDER IMPOSING SOME NEW RULES WHICH WOULD HELP THE INDEPENDENT SMALL BUSINESSES SURVIVE AND WHICH WOULD HELP FOSTER COMPETITION AT THE MARKETING END OF THE INDUSTRY.

THE FOLLOWING POINTS REFER TO THE TEXACO-GETTY MERGER, BUT THE SAME PRINCIPLES APPLY WITH EQUAL MERIT TO THE PENDING SOCAL-GULF MERGER OR WHATEVER THE NEXT ONE WILL BE.

1. TEXACO SHOULD SELL TO THE EXISTING GETTY DEALERS THEIR FACILITIES AT FAIR MARKET VALUE.
2. TEXACO SHOULD HELP DEALERS PURCHASE THEIR STATIONS IN THE SAME MANNER THEY ARE FINANCING POWER TEST'S PURCHASE OF THE 600 GETTY STATIONS.
3. THE SAME ARRANGEMENTS SHOULD BE MADE FOR ANY TEXACO DEALERS WHO WOULD LOSE THEIR LOCATIONS AS A RESULT OF THE MERGER OR SUBSEQUENT DIVESTURE.
4. IN ALL AREAS WHERE THE DEALERS ARE AFFECTED BY THE MERGER, TEXACO MUST DIVEST ITSELF FROM COMPANY-OPERATED SERVICE STATIONS.

5. ALL TEXACO AND GETTY WHOLESALE DISTRIBUTORS BE ALLOWED TO SELL MOTOR FUEL IN ALL MARKETING AREAS, AND THAT THE WHOLESALERS MOTOR FUEL PURCHASES NOT BE RESTRICTED BY CONTRACT VOLUME, AND ALL WHOLESALERS BE ALLOWED TO SELL TO ALL BRANDED OR UNBRANDED OUTLETS.
6. EVERY TEXACO STATION SHOULD BE ABLE TO BUY MOTOR FUEL ON THE OPEN MARKET FROM THE MOST COMPETITIVE SOURCE.

IN THE PAST YEAR, WE HAVE MADE A STUDY OF THE RETAIL MARKET IN SEVERAL COUNTRIES WHICH SHARE THE SAME INTERNATIONAL OIL COMPANIES AS WE DO IN THE UNITED STATES.

IN EVERY CASE, THESE SAME REFINERS HAVE ACHIEVED DOMINATION IN THE OIL INDUSTRY TO THE POINT THEY NOW CONTROL THE RETAIL MARKET AND ITS PRICES IN THAT COUNTRY BY HAVING SIMPLY ELIMINATED COMPETITION.

FOR EXAMPLE IN CANADA, A CONCENTRATION OF POWER IN THE HANDS OF SIX REFINERS (SOON TO BE FIVE) ENABLES THEM NOW TO SET THE RETAIL PRICES IN MORE THAN 90% OF THE SERVICE STATIONS IN CANADA. THE FORMER INDEPENDENT DEALERS ARE NOW COMMISSION AGENTS.

IN AUSTRALIA, A RAILROAD STRIKE AND A HUGE INCREASE IN AUTOMOBILE USE, LAST JULY, SAW THESE SAME COMPANIES SIMULTANEOUSLY INCREASE THE PRICE OF THEIR GASOLINE 25 CENTS PER GALLON OVERNIGHT.

IN ALMOST EVERY COUNTRY, SPECIAL COMMISSIONS ARE NOW WORKING ON RECOMMENDATIONS TO RESTORE COMPETITION IN THEIR RETAIL GASOLINE MARKET. IN MOST CASES IT IS TOO LATE. CANADA'S COMMISSION RECENTLY RECOMMENDED THAT DEALERS WHO HAVE BEEN CAPTIVE-CUSTOMERS

OF THEIR SUPPLIERS BE ALLOWED TO BUY PRODUCT FROM ANY SOURCE, AND THAT THE COMPANIES DIVEST THEMSELVES OF 50% OF THEIR RETAIL OUTLETS.

THESE COUNTRIES ARE AN EXAMPLE OF WHAT WE CAN EXPECT IN THE UNITED STATES IF THE MERGER TREND IS ALLOWED TO CONTINUE. IN A FEW YEARS, WE MAY BE WORKING AS THEY NOW ARE IN CANADA, SWEDEN, JAPAN, AUSTRALIA, BRITAIN, AND EUROPE, AND AS WE HAD TO DO IN THE BREAKUP OF STANDARD OIL, TO RESTORE COMPETITION IN THE OIL INDUSTRY.

THE OIL DAILY, THURSDAY, MARCH 15, 1984

Saudis, Kuwaitis Could Seek Some Gulf Assets

By Stephen Fidler
Reuters Financial News

BAHRAIN — Both Saudi Arabia and Kuwait are likely to be in the market for assets which will probably be sold off to win U.S. approval for a takeover of Gulf Corp., oil industry analysts in the Persian Gulf say.

The $13.2 billion takeover proposed by Standard Oil Co. of California would be the largest in history but needs the approval of the U.S. authorities.

Industry analysts believe the Federal Trade Commission will demand the sale of some of Gulf's downstram assets, including almost 15,000 gasoline stations in the U.S.

Although these refining and marketing assets are in the forefront of the minds of U.S. regulators, they are the least important in the eyes of SoCal.

The company already has said it is willing to sell off anything Gulf owns "other than the exploration and production assets" to secure regulatory approval of the merger.

The analysts said Saudi Arabia and Kuwait would keep a close eye on these assets, some of which would fit closely with their oil marketing strategies. "The U.S. filling stations fit perfectly with Saudi plans and it'll be a surprise to me if they don't go for them," one analyst in the gulf said.

A number of big Saudi refineries and petrochemical plants will come on stream over the next couple of years but the kingdom, which hopes to take five percent of the world petrochemicals market, faces difficulties in marketing its products.

Saudi Oil Minister Sheikh Ahmed Zaki Yamani said in an interview with *The New York Times* in October that his country was seriously considering buying a marketing network.

Saudi Arabia was frustrated in attempts last year to take over Gulf Oil's Italian assets, which along with Gulf properties in Scandinavia and northern Europe were bought by Kuwait.

Sources at the Kuwait Petroleum Co. said Wednesday that Kuwait would be interested in principle in some of the downstream assets which might be sold to effect the merger, but it was premature to speak of negotiations on the possibility.

They said Kuwait had not completed plans for acquisitions in Europe, particularly in Britain, where SoCal also would take over assets Kuwait unsuccessfully sought to buy from Gulf Oil last year.

A Kuwaiti takeover of an American marketing network "might present logistical difficulties," they added.

Senator **Warner**. We certainly went through one of those crisis periods and I remember being on this committee and I remember the contribution you made. We will look after your interests. Thank you.

Before you start, I would like to inquire of the remaining witnesses as to their availability at 2:30 for a followon session. If there are witnesses who cannot be present at that time, then I will take them out of order now in the remaining time until 12:45. If you would be kind enough to stand and indicate your preference to testify between now and 12:45 and your availability at 2:30.

Does anyone have a pressing need that would not be available at 2:30.

Mr. **Schuler**. Mr. Chairman, Henry Schuler, Georgetown University, I have an appointment at 2 o'clock which will not be ended by 2:30.

Senator **Warner**. Is there anyone else? Mr. Lichtblau, you have been before the committee several times. We would like to accommodate you. What is your preference?

Mr. **Lichtblau**. My preference would be to testify now.

Senator **Warner**. We will take you and the other witnesses immediately following this panel.

Mr. **Lichtblau**. Thank you.

STATEMENT OF PHILLIP R. CHISHOLM, EXECUTIVE VICE PRESIDENT, NATIONAL OIL JOBBERS COUNCIL

Mr. **Chisholm**. Mr. Chairman, my name is Phillip R. Chisholm. I am executive vice president of the National Oil Jobbers Council. The NOJC is a federation of some 42 States and regional organizations which represents some 11,000 independent, wholesale, retail marketers of a variety of common stocks. Collectively, our members sell approximately half of the gasoline and about 85 percent of the home heating oil that is consumed in the country.

Today, I would like to have my written statement submitted for the record and just briefly summarize.

Senator **Warner**. Without objection.

Mr. **Chisholm**. During the past 3 months, I think we have witnessed what has been unprecedented in our recent economic history and that is a corporate cannibalism, as major oil companies have begun to merge with one another. This phonemenon is not just limited to the United States. As Mr. Heizer pointed out, it has gone on in Canada, it has gone on in Australia.

In Australia a few years ago, there were nine major companies. That has been reduced to seven. It has been recently reduced to five and the marketers in Australia are reporting concern that it may be reduced to as few as three major companies supplying marketers in that area.

While we have not reached that point yet in this country, there are reasons to be concerned with mergers. First of all, why are mergers occurring? The surface reason, of course, that is given is that it is cheaper to acquire reserves on Wall Street than it is to go out in the oil patch and drill for them. Also it is argued that companies can more economically increase the reserve base by buying their reserves than drilling for them.

I think to some degree, however, there is a weariness, a suspicion that companies are looking over their shoulder fearful that they may be acquired if they do not acquire another company. As a result of that, they are going out and acquiring gigantic amounts of debt by merging with another company before they themselves can be taken over.

Are the mergers good for energy security, national security, and our Nation's economic interest? The economists obviously differ on those major questions. We take a commonsense approach and for reason articulated in my written statement, we think these mergers have a detrimental impact on all of these areas.

When we talk about mergers, we should put it in prospective. Mergers have occurred for many, many years. In our segment of the industry mergers are occurring constantly. Jobbers are joining together consolidating because there is not room in that particular market for two jobbers to exist.

What we are talking about going on in the production level with the integrated companies in the oil industry now are the largest mergers ever to occur in U.S. corporate history. The Gulf/Socal merger, I think was the largest and No. 2 is Texaco/Getty and I think Mobil/Superior ranks about fourth or fifth.

These mergers, certainly the Texaco/Getty question, are in violation of the antitrust laws. The FTC so found in trying to devise consent orders in the Texaco/Getty situation. Given the fact that they do violate the antitrust laws, there should be a higher standard in terms of evaluating what the downstream impacts of those mergers are in the downstream market.

Earlier today, Mr. Pickens stated there were no losers in those mergers and cited the fact that Mr. Lee was given $20 million, and the Gulf shareholders were going to benefit from the mergers, and everybody is leaving happy. I am here to tell you, Senator, that everybody is not leaving happy. There are thousands of independent marketers out there who are extremely concerned about what the impact of those mergers are.

They are not sure of supply. They are not sure what that divestiture that is being ordered by the FTC or may be ordered by the FTC in the Gulf/Socal instance, what impact that will have on their operations. These are businessmen who have been in the business 15, 20, 25 years and they are very, very concerned; Getty marketers in the Midwest and the Northeast; Gulf marketers in the Northeast who called me and said do whatever you can to assure that Chevron will keep us in one divestitus; Gulf marketers in those areas where FTC is expected to order divestiture.

FTC's approach to this whole question seems to be that whatever divestiture is ordered will work itself out downstream. They are making several basic assumptions. Our members are very concerned that the decisions on which these mergers are based not be made on assumption but be made on some type of assurances: Why should a consent order be agreed to until the divestiture that FTC ordered has been completed, so that you can see what the impact on divestiture is going to be before the merger is granted by the Federal Trade Commission.

Again, we are not talking about ordinary mergers that might occur between two small companies, we are talking about, to use an overused phrase, the megamergers, the mergers which FTC has come and said file the Clayton Act of violation law and you have got to reach a consent order to breach it.

What is the solution to all of this? We cannot and do not believe that S. 2362, which Senator Johnston introduced, is the best way to do it. We think it perhaps provides disincentives. We did support a moratorium on mergers because we felt like that would provide adequate time to more carefully evaluate the questions surrounding the merger issue.

We believe instead that guidelines under the Federal Trade Commission and the Justice Department review of these mergers ought to be reviewed and analyzed. The oil industry is perhaps unique in that the mergers which are occurring have tremendous downstream impacts and require tremendous downstream spinoffs of properties and facilities that are not traditional in any other industry.

We support the concept of a public interest test prior to Federal approval of large corporate mergers. We believe such a test would require the Federal Trade Commission and the Department of Justice to undertake a more comprehensive inquiry into the competitive effect of such a megamerger.

We believe the public interest test could be viewed as a way of expanding the FTC's and the Justice Department's current merger and antitrust guidelines to include an extensive review of the downstream competitive effects of mandated divestitures emanating from the federal antitrust review.

Mr. Chairman, I will be happy to answer any questions you might have in regards to this study.

[The prepared statement of Mr. Chisholm follows:]

nojc

TESTIMONY OF

PHILLIP R. CHISHOLM

On Behalf Of The

NATIONAL OIL JOBBERS COUNCIL

Before The

SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES SUBCOMMITTEE

On

ENERGY AND MINERAL RESOURCES

April 10, 1984

PREFACE

The National Oil Jobbers Council is a federation of 42 state and regional trade associations representing thousands of independent small business petroleum marketers. Members include gasoline and diesel fuel wholesalers, commissioned distributors of gasoline, gasoline reseller-retailers and a large number of retail fuel oil dealers. Members also wholesale or retail many other petroleum products, including kerosene, LP gas, aviation fuels and motor oils as well as residual fuel oil. Together our members market approximately 50 percent of the gasoline and 85 percent of the home heating oils sold in America under either their own private brand or the trademark of their supplier.

© NOTICE: ALL RIGHTS RESERVED
including the right to reproduce
this material or any part thereof
in any form. Written permission
must be secured from the National
Oil Jobbers Council.

Mr. Chairman and members of the Committee my name is Phillip R. Chisholm. I am Executive Vice President of the National Oil Jobbers Council (NOJC). NOJC is a federation of 42 state and regional associations which represents some 11,000 independent, small business petroleum products marketers. Collectively these companies sell nearly 50 percent of the motor gasoline and 85 percent of the home heating oil sold in the United States each year.

We sincerely appreciate this opportunity to appear before the Committee and express our concerns about the recent wave of mergers among the major oil companies. We do indeed have some serious concerns with these "mega-mergers" and we believe they raise a number of questions, questions which have yet to be satisfactorily answered. Our concerns center around several areas and I would like to touch briefly on just a few of those areas.

IMPACT ON COMPETITION

Perhaps our first and foremost concern is the potential long-term impact such mergers will have on competition within the petroleum industry and upon the independent petroleum marketers represented by the National Oil Jobbers Council. In our view, competition at virtually every level of the industry is clearly threatened by the oil industry mergers. Our most immediate concern, however, is the impact these mergers will have on downstream marketing, the segment of the industry in which our members are most involved, and the segment which we believe to be one of the most competitive in the entire petroleum industry..

The FTC, as evidenced by the proposed consent order in the Texaco-Getty merger, appears to focus only on the competitive concerns created by the horizontal market overlaps between the two companies. The remedy of company spin-offs of downstream marketing operations may solve the immediate problems posed by these horizontal overlaps. However, this remedy fails to take into consideration the continuing viability of divested downstream operations. Particularly in the oil industry, the divested units are often franchisees which are protected by other laws, the Petroleum Marketing Practices Act, for example. Divestiture without consideration of the interests, competitive viability and legal protections of these small business franchisees harms them by depriving them of their source of supply and services. These short-sighted spin-offs may in fact create even greater competitive problems, for if these divested units are not viable competitors after spin-off, their demise could lead to just the kind of anticompetitive situation which the antitrust laws and the FTC and Department of Justice guidelines are designed to prevent.

Moreover, the acquiring companies are playing a game of "briar rabbit" when they are "ordered" to sell downstream marketing operations. In the Texaco-Getty example, many of the properties Texaco is being told to sell off in the midwest are in areas from which Texaco had long since withdrawn and is no longer serving. In the proposed Socal-Gulf merger, Socal would probably be willing to sell off even more of Gulf's refining and marketing facilities than even the FTC may require.

In essence, the competitive impacts of these mergers with the anticipated spin-offs are three-fold. First, the markets served by the company being acquired (i.e. Gulf or Getty) lose a major competitor. Any new company which may acquire those spin-off facilities is not likely to be as strong a competitor as the company it replaced, unless it too is a major integrated company. NOJC would consider a non-integrated marketing company to be a weaker supplier for divested independents in that such a supplier would not have access to crude oil, especially during a shortfall emergency.

Second, the other major integrated companies still competing in the divested markets would be in a much stronger position. A major competitor's sale of assets and supply contracts to a less competitive third party could result in anticompetitive market concentrations in future years.

Finally, the acquiring company will have enhanced its position in the market because it has greatly increased its crude oil reserves at a fraction of the cost of new exploration and production and has been ordered by the government to sell off what are generally considered the most unprofitable aspects of the acquired company.

The bottom line in such an analysis is that the major integrated companies tremendously enhance their posture in the market while virtually every independent competitor is hurt. Some people may be comfortable with the consequences of that situation. The National Oil Jobbers Council is not.

Mr. Chairman, please do not misunderstand our posture. We have long questioned the efficiencies of integration, particularly as applied to downstream marketing. We continue to believe that independent marketers are the most efficient marketers in the gasoline business. That functional efficiency, however, is rendered irrelevant if a major integrated company uses upstream crude oil profits to subsidize its downstream markets. We have alleged previously and we still believe that such subsidies exist.

With these mergers, however, fewer and fewer companies will be in a position to provide such marketing subsidies thus putting those few companies which can in a posture to take over any major markets they desire. Critics of the oil industry have for years talked of "The Seven Sisters" and the power they wield in the industry. If the mergers continue will there one day be only three or four "sisters", or perhaps two? What effect would that have on competition?

Allowing these mergers could provide the clarion call for a major legislative restructuring of the petroleum industry such as crude oil divestiture.

IMPACT ON EXPLORATION AND DEVELOPMENT OF NEW RESOURCES

NOJC is also concerned that mergers involving billions of dollars cannot help but have a negative impact on exploration and production of new domestic oil resources. The Texaco-Getty, Socal-Gulf and Mobil-Superior proposed mergers would involve an expenditure of nearly $30 billion and yet would not result in a single new barrel of oil. In testimony before Congress a few years ago, one of the Hunt brothers reportedly made the observation that "A billion dollars isn't what it used to be." There may be some validity to that observation, but common sense would seem to dictate that when a company, no matter how large, spends billions of dollars to acquire the existing reserves of another company, the incentive for the acquiring company to invest additional capital in possible risky new exploration activity is diminished.

As the incentive to drill for new domestic reserves is reduced by these mergers, the dependence on unstable foreign supplies is sure to be increased. This has a negative impact on the United States' balance of payments, as well as threatening the country's national security.

THREAT OF MORE MERGERS

Any of the announced mergers, if examined separately from the others, may not raise as many questions and concerns. It would be almost akin to examining a single piece of a puzzle. Only when that piece is combined with other pieces does the true picture emerge. Thus, it is with the mergers. Three major mergers have been announced within the last 90 days. Wall Street analysts are speculating on the companies which might be the next takeover target, and at least half a dozen companies are on that list. The mere threat of being taken over can lead a company to take actions which may not be in its own long-term best interests. The March 19 issue of Business Week magazine made the following observation: "Oil companies are under intense pressure to survive by getting bigger through acquisitions and uglier with debt -- even though the rising leverage raises risks."

OTHER IMPACTS

There are a whole range of other factors to consider as part of these mergers. For example, what are the consequences of the merger on net revenue to the federal government? Acquiring companies will be able to write off from their federal taxes the interest paid on the money borrowed to finance the acquisition. In addition, it will be able to depreciate and amortize the assets acquired from the acquired company.

What are the impacts on energy resources other than oil or gas? What do these mergers do in terms of combining other energy resources such as coal and nuclear energy?

What do these mergers mean in terms of unemployment?

What ramifications will these mergers have on small business competitive franchisee customers of the acquired company?

What are the impacts of the mergers on the state and local economies in those areas directly affected?

These are questions we cannot answer, but which we believe need to be addressed prior to any final approval of the mergers.

REVIEW OF PROPOSED LEGISLATION:

While NOJC does not believe that S. 2362 is the best way of dealing with the merger issue, we do strongly support what we believe to be its basic intent -- that is to examine the serious public policy issues involved in the merger trend. Restricting access to the resources on Federal lands to merger parties probably does more to joepardize our nation's energy security than to enhance it.

We believe instead that the guidelines under which the Federal Trade Commission examines major corporate mergers should be re-evaluated. The oil industry is perhaps unqiue in that mergers of the magnitude we are now witnessing can only be approved if certain downstream assets are divested. The real impact of such divestitures have never been examined. We would recommend that final FTC approval of any of these mergers not be given until the ordered divestitures are completed and the full impact of the mergers, including the impact on downstream operations, can be carefully assessed.

The NOJC also supports the concept of a "public interest test" prior to federal approval of large corporate mergers. We believe such a test would require the Federal Trade Commission and the Department of Justice to undertake a more comprehensive inquiry into the competitive effects of such mega-mergers.

We believe a "public interest test" could be viewed as a way of expanding the FTC's and the Justice Department's current merger and antitrust guidelines to include an extensive review of the downstream competitive effects of mandated divestitures emanating from the federal antitrust review.

An expanded federal review of proposed mega-mergers under the "public interest test" should examine the eventual effects of spin-off actions on franchisees and other marketer customers of the two merging companies, such as: (1) ensuring that federally ordered divestitures do not preempt legal rights and protections which franchisees and customers now have with regard to leases or supply contracts (for example, do "branded" petroleum marketers stand to lose their franchise rights granted under the Petroleum Marketing Practices Act - P.L. 95-297); (2) ensuring that downstream competition is not harmed because the spun-off properties and contracts are sold to a third party which is not as viable a competitor as either the acquired or acquiring company; and (3) ensuring that franchisees and other customers are provided with existing franchise and legal protections even when sold to a third party as part of a federally mandated divestiture action.

NOJC would also suggest that, in addition to the "public interest test", that the FTC and the Justice Department consider what compensation might be appropriate for those franchisees and other customers which have long established relationships with merging companies and are slated for sale to a third party. Tremendous amounts of goodwill have been gained by many small business franchisees over decades of service to major corporations. If these franchisees stand to lose brand identity, national advertising, credit programs and established credit terms, which a third party cannot provide as part of a federally mandated divestiture action, should not these companies be compensated for the goodwill washed down the drain by a federal consent decree?

SUMMARY

This country has enjoyed a period of relative energy stability over the past few years, but that very stability may have led us to drop our guard somewhat. It would behoove us to remember that today's so-called "glut" can suddenly and unexpectedly become tomorrow's shortage. The recent trend to acquire oil reserves via mergers and acquisitions does not bode well for competition within the oil industry, for new exploration and development, for American consumers or for our national security.

Perhaps the thing to keep foremost in mind is that despite the tens of billions of dollars being spent on the mergers, despite the potential threat these mega-mergers pose to competition and to national security, and despite all the other possible consequences associated with the mergers, not a single barrel of new oil will have been added to our reserve base.

We also believe that the FTC and Department of Justice Merger Guidelines must be expanded to include consideration of the effects on small business franchisees of merger approval mechanisms such as divestiture. Currently these Guidelines are written so as to effectively preclude appropriate review of these downstream effects.

Again, Mr. Chairman and members of the Committee, thank you for allowing us to be here today. I will gladly answer any questions you may have.

MEMBERS OF THE NATIONAL OIL JOBBERS COUNCIL

NOJC represents these member associations:

Alabama Oilmen's Association
Arizona Oil Marketers Association
Arkansas Oil Marketers Association, Inc.
California Independent Oil Marketers Association
Colorado Petroleum Marketers Association
Independent Connecticut Petroleum Association
Florida Petroleum Marketers Association
Georgia Oilmen's Association
Idaho Oil Marketers Association
Illinois Petroleum Marketers Association
Indiana Oil Marketers Association, Inc.
Intermountain Oil Marketers Association
Petroleum Marketers of Iowa
Kansas Oil Marketers Association
Kentucky Petroleum Marketers Association
Louisiana Oil Marketers Association
Maine Oil Dealers Association
Michigan Petroleum Association
Mid-Atlantic Petroleum Distributors Association,Inc.
Mississippi Petroleum Marketers Association
Missouri Oil Jobbers Association
Montana Chapter, Intermountain Oil Marketers Association
Nebraska Petroleum Marketers, Inc.
Independent Oilmen's Association of New England
Fuel Merchants Association of New Jersey
New Mexico Petroleum Marketers
Empire State Petroleum Association
North Carolina Oil Jobbers Association
Northwest Petroleum Association
Ohio Petroleum Marketers Association
Oklahoma Oil Marketers Association
Oregon Oil Jobbers Association
Pennsylvania Petroleum Association,Inc.
South Carolina Oil Jobbers Association
South Dakota Petroleum Marketers Association
Tennessee Oil Marketers Association
Texas Oil Marketers Association
Virginia Petroleum Jobbers Association
Washington Oil Marketers Association
West Virginia Oil Jobbers-Distributors Association
Oil Jobbers of Wisconsin, Inc.
Wyoming Petroleum Marketers Association

National Oil Jobbers Council
1707 H Street, N.W.
Washington, D.C. 20006

(202) 331-1198

Senator **Warner**. In the remarks of both witnesses, you have expressed your general concern on behalf of your constituents. I wonder if the concerns that you have expressed could not be precipitated by other causes other than mergers; that merger is not the sole perpetuator of the concerns that you have expressed today. You could have direct buyouts from a corporation in the United States as opposed to fallout of merger activity.

Mr. **Heizer**. Not solely, but the mergers, of course, are a part and parcel of the overall picture and our very deep concern is the fact that many of these dealers are not having the opportunity to purchase their properties. When the Federal Petroleum Marketing Practices Act was enacted about 5 years ago, we felt that it would give dealers protection so in the event of buy-out and takeover, of merger, that they would have the opportunities—for example, another illustration, in Virginia right now we have Sun Oil pulling out of Florida and Virginia with the exception of the immediate northern Virginia area.

There are approximately 70 Sunoco dealers in Virginia that do not know whether they are going to be in business after July or not. There is provision under the Federal act which allows them to sell them off in bulk, so they are seeking a large oil company or perhaps a big jobber who will buy all of these stations in bulk. And many of these dealers have approached Sun Oil and said we want to buy our location; give us a price and see if we can afford it and they will not even offer the stations to them, because they want to sell them off in bulk.

Mr. **Chisholm**. I think everyone recognizes there are a lot of problems in the industry and that a lot of things have occurred since decontrol which are a result of mergers. Mergers may in fact be a reflection of those changes and those shifts. But it would be very, very difficult to convince such Getty marketers in the northeast who are now being supplied by another distributor rather than a major and great refiner, it would be very difficult to convince the Getty marketer in the midwest, who owns a truck stop and has had that truck stop supplied by major suppliers and all of a sudden he is not sure who his supplier will be or if he will have a supplier.

It is hard to convince the Gulf marketers in the southeast and in the northeast and throughout the country about who their supplier is going to be and whether that supplier will be as competitive and viable, that the problem is not the merger but other factors. And that is the issue we are dealing with.

And all we are really saying is that there may not be a problem. But we do not think the FTC or anyone else has looked carefully enough at what those potential problems may be and what the divestiture actions they are ordering, what impact they are going to have and whether they will in fact work.

Senator **Warner**. Thank you, gentlemen.

We will have our next panel. Mr. John Lichtblau, president, Petroleum Industry Research Foundation; Mr. Henry M. Schuler, director of Bartlett Council on Energy and National Security; Mr. Milton A. Copulos, senior analyst, Energy and Natural Resources.

Mr. Lichtblau, you understand the issue very well and the committee is anxious to have your views on the issues before us this morning. We have got your testimony.

STATEMENT OF JOHN H. LICHTBLAU, PRESIDENT, PETROLEUM INDUSTRY RESEARCH FOUNDATION, INC.

Mr. **Lichtblau.** Thank you, sir. For the record, my name is John Lichtblau. I am president of Petroleum Industry Research Foundation. I would like to read an abbreviated portion of my testimony.

I would like to address four major questions on this issue frequently asked. No. 1, are there compelling structural factors underlying the recent trend of oil company mergers? No. 2 will mergers have an effect on oil and gas prices? No. 3, will mergers affect domestic exploration activities and, No. 4, what are the potential consequences of converting a corporate oil operation into a royalty trust?

Let me start by briefly summarizing our conclusions, so that you know where we stand. In our view, clearly visible structural changes in the U.S. petroleum industry has created a compelling logic for this industry to move towards consolidation in the form of mergers and acquisitions. We recognize that if this trend were to continue unabated at its current rate, it could eventually conflict with the public interest, but we believe counterveiling corrective economic forces, together with existing antitrust regulation, will curb the merger trend well before then.

Two, given current and expected world oil market conditions and the near certainty that the United States will remain a substantial net oil importer for the foreseeable future, a change in the number and size of U.S. oil companies through mergers or acquisitions would not measurably change the determinants of U.S. oil prices. These determinants will continue to be located outside the United States.

Three, we disagree with the view that a large share of the capital spent on mergers and acquisitions could or would otherwise be channelled into exploration activities, thereby increasing the stock of U.S. oil and gas reserves. We recognize the possibility that the immediate financial requirements of a merger could bring about some short-term reduction in a company's exploration expenditures.

However, this would represent only a delay in exploration activity and thus would have no long-term effect on production. The underlying incentives to replace declining reserves and the industrywide response to them will not be affected by mergers or acquisitions.

However, four, the same cannot be said about such devices as royalty trusts which could very well have a longer term negative impact on the replacement of domestic reserves.

Let me now briefly talk about the structural changes. The U.S. industry has been characterized by two basic structural changes: A decline of its domestic resource base and a reduction of its products market. Both trends are well known and require little elaboration. The oil industry has clearly been unable to replace its domestic reserves.

A recent study of 300 publicly owned U.S. oil and gas companies shows that during the 3-year period 1980 to 1982 they replaced only 53 percent of their domestic crude oil reserves and 81 percent of their gas reserves. Yet, these dismal results were certainly not due to reduced expenditures or activities for finding oil and gas.

From 1973–1981, U.S. exploration expenditures rose from $5.4 billion to $30.7 billion. During about the same period the annual number of exploratory wells more than doubled as did the average depth of these wells.

If expenditures and efforts of this magnitude were unable to arrest the decline in domestic reserves, the reason must be sought in geological and technical limitations to oil exploration rather than in insufficient investment. In fact conventional oil exploration continues to be a very attractive investment in the United States and so will gas exploration once the current surplus has been absorbed. However, the exploration prospects have been steadily declining and no reversal of this trend is expected.

Clearly, if an oil company cannot come close to replacing its reserve base through exploration, supplementing its exploration activities by purchases of existing reserves makes commercial sense. It is not a question for these companies of either exploring or purchasing but of doing both in the hope of slowing down the depletion of its resource base.

The other structural change has taken place in the downstream market. U.S. oil demand has been declining rapidly over the past 5 years for all major products. This has, of course, caused a substantial underutilization of the industry's refining, distribution and retailing capacity which had been built on the general assumption that by 1984 consumption would be significantly higher than in 1978.

Consumption is now beginning to rise, but the current view in the industry is that by 1990 demand will not differ significantly from this year's level.

The decline in consumption has been reflected in the closing of some refineries and service stations. But there is clearly still substantial excess capacity in the entire downstream sector. Consolidation of capacity to improve the efficiency of operating equipment is a logical, rational response to this development and economically beneficial as long as it does not violate antitrust restrictions.

We recognize, of course, that the current reason for oil company mergers and acquisitions is access to reserves in the ground and not consolidation of downstream equipment. However, the latter as a by-product of the former does serve the need to reduce obsolete excess downstream capacity.

A concern has been expressed that this development may lead to undue market concentration. On a national level, this is quite unlikely, since the oil industry is among the least concentrated U.S. industries. Neither the Chevron/Gulf nor the Mobil/Superior merger would significantly change this.

The so-called Herfindahl-Hirschman Index used by the Department of Justice and the Federal Trade Commission to calculate concentration levels shows that the U.S. oil industry is one of the least concentrated industries in the United States and the two recent mergers would not come anywhere near to change the index where it would be a matter of concern for either of these two Government agencies.

The situation may, of course, be different regionally or locally, particularly in the downstream sector where a merger may create an undesirably high market concentration. The Justice Department and the FTC have the authority and the duty to prevent such concentration. As we know, the FTC has actually done so in a number of cases.

Following the recent Texaco/Getty merger, as was mentioned earlier here, virtually all of Getty's marketing facilities in the Northeast and mid-Atlantic States were sold to Power Test Corp., an independent regional gasoline marketer whose market share increased vastly, while Getty, a major integrated oil company, disappeared from the scene.

Mergers and oil prices. The principal consumer interest in the current merger debate is what mergers would do to prices of oil products. Currently, these prices are determined by two factors, the cost of crude oil and the market competition among refiners and distributors. The cost of crude oil has been unilaterally determined by OPEC since 1973 and it appears this will continue to be the case.

But regardless of how the world oil price is set, as long as the United states remains a substantial net importer of crude oil, the U.S. price will continue to be determined by the landed cost of imported oil. Regarding product prices, these will continue to be determined by market factors.

Since most U.S. refining companies are likely to have excess capacity and ready access to incremental crude oil products price competition should remain strong. Furthermore, given the relatively insignificant tariff levels on imported products, foreign competition will continue to play an active role in setting U.S. products price ceilings.

Regarding merger payments and exploration expenditures, I would like to make the point that the acquisition of additional reserves through merger or acquisition does not lower a company's incentive to look for new reserves. The reason is that the old reserves and the acquired reserves will both be produced at the maximum efficient rate and will therefore deplete just as fast as before the merger.

The company will produce at that rate to repay the loan to maximize the profitability of its investment and because royalty agreements and other factors would prevent it from arbitrarily shutting in production.

It is, of course, possible that the financial strain of a merger will cause a company to temporarily reduce expenditures to improve its debt-equity ratio. However, most of the money required to pay for merger or acquisition does not come from a company's own operating funds but is borrowed for the purpose of acquiring the property.

While the repayment of this loan could temporarily reduce funds available for exploration, the need to replace the depleting reserves is as strong as before. Therefore, companies can be expected to restore any such temporary reduction in their exploration expenditures as their debt burden declines. Thus, our earlier point that increasingly the limit to U.S. exploration is not access to funds but access to prospects, remains valid.

Senator **Warner**. I regret to say I have got to allocate the time. We will resume at 2:30 in order to make the record complete.

Mr. **Lichtblau**. I am just about finished. I have come down to the last sentence. I will conclude that there presently is no need for special legislation curtailing oil company mergers. I have some comments on royalty trusts, which you may want to take up in the question and answer period.

Thank you.

[The prepared statement of Mr. Lichtblau follows:]

PIRINC

Telephone: (212) 867-0052

Petroleum Industry Research Foundation, Inc.

122 EAST 42nd STREET

New York, N. Y. 10168

OIL COMPANY MERGERS AND COMPETITION

Statement before the

Subcommittee on Energy and Natural Resources

of the

Senate Energy Committee

by

John H. Lichtblau
President

Washington, D.C.
April 10, 1984

Thank you for inviting me to testify before your subcommittee on the subject of oil industry mergers.

In my testimony I would like to address four of the most frequently asked questions on this issue: (1) Are there compelling structural factors underlying the recent trend of oil company mergers? (2) Will mergers have an effect on oil and gas prices? (3) Will mergers affect domestic exploration activities and, hence, our dependency on foreign oil supplies? and, (4) What are the potential consequences of converting a corporate oil operation into a royalty trust?

As we all know, in the current debate the answers to these questions are quite controversial. Let me therefore start by briefly summarizing our conclusions, so that you know where we stand.

(1) In our view, clearly visible structural changes in the U.S. petroleum industry, some starting in 1979 and some considerably earlier, have created a compelling logic for this industry to move towards consolidation in the form of mergers and acquisitions. We recognize that if this trend were to continue unabated at its current rate it could eventually conflict with the public interest but we believe counterveiling corrective economic forces, together with existing anti-trust regulation, will curb the merger trend well before then.

(2) Given current and expected world market conditions for crude oil and refined products and the near certainty that the U.S. will remain a substantial net oil importer for the

foreseeable future, a change in the number and size of U.S. oil companies through mergers or acquisitions would not measurably change the determinants of U.S. crude and refined products prices. These determinants will continue to be located outside the U.S.

(3) We disagree with the view that a large share of the capital spent on mergers and acquisitions could or would otherwise be channelled into exploration activities, thereby increasing the stock of U.S. oil and gas reserves. We recognize the possibility, but not the inevitability, that the immediate financial requirements of a merger could bring about some short-term reduction in a company's exploration expenditures. However, this would represent only a delay in exploration activity for the company, and thus would have no long-term effect on production. The underlying incentives to replace declining reserves and the industry-wide response to them will not be affected by mergers or acquisitions. However, (4) the same cannot be said about such devices as *royalty trusts* which could very well have a longer term negative impact on the replacement of domestic reserves.

Structural Changes in the U.S. Oil Industry

The U.S. oil industry has been characterized by two basic structural changes: a decline of its domestic resource base and a reduction of its products market. The first has been underway since the late 1960's, the second since the late 1970's. Both trends are well known and require little elaboration. U.S. crude oil reserves have declined in every year but one since 1968. The exception was 1971 when Prudhoe Bay reserves were included in the U.S. total. From then until 1982 U.S. crude oil reserves dropped by nearly 14 billion barrels. Production also dropped during this period but reserves dropped faster so that in 1982 U.S. crude reserves were equal to only 9.4 years of production, compared to 11.4 years in 1972. Approximately the same development took place in the natural gas sector where the reserve/production ratio dropped from 11.5 to 10.8 years despite a 21% drop in production during this period.

Thus, the U.S. oil industry has clearly been unable to replace its domestic reserves. A recent study by the accounting firm Arthur Anderson & Co. of 300 publicly owned U.S. oil and gas companies shows that during the 3-year period 1980-82 they replaced only 53% of their domestic crude oil reserves and 81% of their gas reserves. Our own calculations of the 23 largest integrated oil companies show a similar result: they replaced 68% of their combined oil and gas production during this period.

Yet, these dismal results were certainly not due to reduced expenditures or activities for finding oil and gas. From 1973 to 1981 U.S. exploration expenditures rose from $5.4 billion to $30.7 billion, an annual growth rate of 24%. During about the same period (1973-82) the annual number of exploratory wells rose from 7,500 to 16,500, with an increase registered in every single year. Furthermore, the average depth of these wells more than doubled during this period.

If expenditures and efforts of this magnitude were unable to arrest the decline in domestic reserves the reason must be sought in geological and technical limitations to oil exploration, given the existing state of the art, rather than in insufficient investment. In fact, conventional oil exploration continues to be a very attractive investment in the U.S. and so will gas exploration once the current surplus has been absorbed. However, the exploration prospects have been steadily declining and no reversal of this trend is expected.

The Alaskan North Slope is a case in point. In 1968/69 two super giant fields, Prudhoe Bay and Kuparuk, were discovered there. In the 15 years since then vast sums have been expended on the assumption the area must contain other giants. Yet, so far, only a few relatively much smaller fields have been discovered, and even these are just now being commercially developed.

Clearly, if an oil company cannot come close to replacing its reserve base through exploration, supplementing its exploration activities by purchases of existing reserves makes commercial sense. It is not a question for these companies of either exploring or purchasing but of doing both in the hope that the combined effect will slow down the depletion of its resource base.

The other structural change has taken place in the downstream market. U.S. oil demand has been declining regularly over the past five years for all major products. In 1983 total demand of 15.2 million B/D was 20% below the 1978 peak. This has of course caused a substantial underutilization of the industry's refining, distribution and retailing capacity which had been built on the general expectation that by 1983 consumption would be significantly higher than in 1978. Consumption is now beginning to rise again. But the current view in the industry is that by 1990 demand will not differ significantly from this year's level.

The decline in consumption has been reflected in the closing of some 80 refineries since 1980 and 25,000-30,000 service stations since 1978. But there is clearly still substantial excess capacity in the entire downstream sector. Thus, U.S. refinery distillation is still utilized at less than 75% of capacity. Consolidation of capacity to improve the efficiency of operating equipment is a logical, rational response to this development and is economically beneficial as long as it does not violate anti-trust restrictions.

We recognize of course that the current reason for oil company mergers and acquisitions is access to reserves in the ground and not consolidation of downstream equipment. However, the latter, as a by-product of the former, serves the need to reduce obsolete excess downstream capacity.

A concern has been expressed that this development maylead to undue market concentration. On a national level this is quite unlikely, since the oil industry is among the least concentrated U.S. industries. Neither the Chevron-Gulf nor the Mobil-Superior merger would significantly change this. The so-called Herfindahl-Hirschman Index (HHI) used by the Department of Justice and the Federal Trade Commission to calculate concentration levels in U.S. industries shows the 1982 concentration levels for the domestic petroleum industry (after adjustment for the Texaco-Getty merger) at 270 points for liquid petroleum production, 329 points for liquid petroleum reserves and 410 points for refining capacity. According to the Justice Department's merger guidelines, "a challenge (to a merger) is unlikely under any facts when the HHI value after the merger is below 1000 points." The two new mergers would not move the HHI even remotely close to 1000 in any category.

The situation may of course be different regionally or locally, particularly in the downstream sector where a merger may create an undesirably high market concentration ratio in a given area. The Justice Department and the FTC have the authority and the duty to prevent such concentration by requiring the merged companies to dispose of the overlapping part of their facilities. As we know, the FTC has done so in a number of cases.

Such required sales can actually benefit the independent sector of the market. Following the recent Texaco-Getty merger virtually all of Getty's marketing facilities in the Northeast and Middle Atlantic states were sold to Power Test Corporation, an independent regional gasoline marketer whose market share increased vastly, while Getty, a major integrated oil company, disappeared from the scene.

Mergers and Oil Prices

The principal consumer interest in the current merger debate is what mergers would do to the retail price of gasoline, heating oil and other products. Currently, these prices (excl. excise taxes) are determined by two factors: the cost of crude oil to refiners and market competition among refiners and distributors. The cost of crude oil has been unilaterally determined by OPEC since 1973 and it appears this will continue to be the case in the foreseeable future. But regardless of how the world oil price is set, as long as the U.S. remains a substantial net importer of crude oil, the U.S. price will continue to be determined by the landed cost of imported oil which will remain the marginal supply source for U.S. refiners and thus determine the price for all U.S. crudes. Thus, the price of U.S. or imported crude oil will be unaffected by the concentration ratio of U.S. crude oil producers.

Of course, there could be local exceptions to this. However, there is a mechanism in place to deal with such situations--the FTC's case-by-case review of the impact of mergers on competition.

Regarding products prices, these will continue to be determined by market factors. Since most U.S. refining companies are likely to have excess capacity and ready access to incremental crude oil volumes in the foreseeable future, products price competition should remain strong. Furthermore, given the relatively insignificant tariff levels on imported products, foreign competition will continue to play an active role in setting U.S. products price ceilings, particularly when the OPEC export refineries currently under construction are completed.

Merger Payments and Exploration Expenditures

The first point I would like to make on this subject is that the acquisition of additional reserves through merger or acquisition does not lower a company's incentive to look for new reserves. The reason is that the old reserves and the acquired reserves will both be produced at the maximum efficient rate and will therefore deplete just as fast as before the merger. The company will produce at that rate to repay the loan it received for the acquisition, to maximize the profitability of its investment and because royalty agreements, field unitizations and other factors would likely prevent it from arbitrarily shutting in production for which there is a ready market. The almost complete absence of shut-in crude oil producing capacity in the U.S. since 1971 is a reflection of these factors.

It is of course possible that the financial strain of a merger will cause a company to temporarily reduce all expenditures to improve its debt-equity ratio. However, most of the money required to pay for merger or acquisition does not come from a company's own operating funds but is borrowed for the purpose of acquiring the property. While the repayment of this loan could temporarily reduce funds available for exploration, the need to replace the depleting reserves is as strong as before. Therefore companies can be expected to restore any such temporary reduction in their exploration expenditures as their debt burden declines. One must also consider the possibility that the cost of exploration could actually be reduced somewhat by mergers, thus leaving the industry more funds for exploration activities. The reduction would result from fewer companies bidding for acreage, thereby tending to lower lease bonus payments. Thus, our earlier point that, increasingly, the limit to U.S. exploration is not access to funds but access to prospects, remains valid.

Altogether, then, there is presently no need for special legistlation curtailing oil company mergers.

The Role of Royalty Trusts

The merger debate has also included the role of royalty trusts in the current restructuring of the U.S. oil industry. Presumably, the Senate will study these too. They are very different from mergers. Their function is to accelerate the cash flow to shareholders by liquidating the oil reserve asset in trust and distributing the proceeds to its owners. Royalty trusts have tax advantages over corporations, including the avoidance of double taxation for shareholders (on corporate earnings and on distributed dividend earnings). However, these trusts are not designed for reinvestment of any part of the cash flow to replace the depleting reserve. In fact, the depletion allowance which permits the tax free recovery of capital from the producing property, goes directly to the trust owners who are far less likely to reinvest it in oil exploration than an operating oil company would be. Thus, if a corporate oil producer is turned into a royalty trust, as had been proposed for Gulf Oil, the funds availabe for exploration would indeed be severely curtailed.

Royalty trusts may provide a useful vehicle for independent oil operators to attract funds, primarily for development drilling, from outside investors. However, the conversion of existing corporate oil operations into royalty trusts tends to create a potential conflict between the short term and long term interests of corporate shareholders. But one could argue that the long term corporate interest in the continuity of its resource base is closer to the national interest than short term stockholder preference for maximizing income by depleting the resource.

STATEMENT OF G. HENRY M. SCHULER, DEWEY F. BARTLETT CHAIR IN ENERGY SECURITY STUDIES, CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES, GEORGETOWN UNIVERSITY

Mr. SCHULER. Thank you, Mr. Chairman. I hold the Dewey F. Bartlett chair in Energy Security Studies at Georgetown University's Center for Strategic and International Studies. Therefore, the entire focus of my testimony is with respect to the energy security concerns.

I would say this that there is a link between the mergers and our energy security, but it is not that the mergers create energy security concerns, but rather they reflect underlying circumstances that constitute an energy security threat to this country.

Just to go over very quickly the points that I would make, the reason the stock prices are depressed is a complacency about energy companies that is descending over the energy concerns over the last couple of years, the same complacency that is reflected on Capitol Hill and elsewhere in terms of legislation that is no longer driving to develop domestic resources.

As a result of that, the acquired companies are undervalued and they are available. Similarly, what should be energy security concerns in this country are what motivate acquiring companies to take over and that is the decline in proving U.S. oil reserves. Those reserves are down in the current rate of consumption to an 8.5 year level.

Therefore, an integrated marketing refining company that wishes to survive into the future and to grow must acquire additional oil through one of three means. It can either acquire oil in the ground by taking over some other company. It can proceed with exploration or it can import that oil.

Now, these companies have been very successful at exploration, the acquiring companies, but they cannot be sure that they will have the opportunity, that they will be allowed to retain the earnings that will be sufficient to enable them to acquire through exploration additional reserves in the future. So it makes sense for them to hedge their bets by acquiring oil in the ground.

The other alternative that these companies have is to import oil. I think it is particularly noteworthy that the three companies that are the subject of the concern at this time, the acquiring companies, are all members of ARAMCO, who have as good access and as great knowledge of anybody of the oil situation in the Middle East. I think the fact that they choose not to rely on imports, but rather to risk their credit ratings and their stock prices in order to acquire domestic reserves is an indication that those companies do not share the complacent view of the Middle Eastern oil supplies that so many people do.

The other question that I would address is that if there is a concern, if the underlying circumstances create a concern, is this an appropriate response to those mergers? I would have to say that I think that creating stronger companies enhances the ability of those companies to go out into the deep offshore areas and the remote areas of Alaska where the big reserves are going to be found.

Because what that requires is not a lot of new innovative techniques, exploration plays, but rather the mobilization of capital, the mobilization of engineering and research and development and those companies will do that. And when in addition they have to go out to negotiate for incremental oil supplies from elsewhere around the world, they will have controlled reserves that will enhance their position.

As a result of this, at the end of the day, I think that the security benefits to the Nation certainly outweigh any risks to competition or other concerns that people have expressed.

Thank you.

[The prepared statement of Mr. Schuler follows:]

ENERGY COMPANY MERGERS
BALANCING THE COMPETITION RISKS AGAINST THE SECURITY BENEFITS

Testimony
submitted to
Senate Subcommittee on Energy & Mineral Resources
Senate Energy Committee
Hearings
on Oil Company Mergers

April 10, 1984

G. Henry M. Schuler
Dewey F. Bartlett Chair
in Energy Security Studies

Center for Strategic and International Studies
Georgetown University
1800 K Street, N.W.
Washington, D. C. 20006

(202) 775-3256

My name is G. Henry M. Schuler, and I have held the Dewey F. Bartlett Chair in Energy Security Studies at Georgetown University's Center for Stretegic and International Studies (CSIS) since the Bartlett Program was established 18 months ago. While I do not speak for CSIS (which does not adopt institutional positions), I do speak as someone who has been concerned about our nation's energy security ever since Colonel Qaddafi seized power in Libya 15 years ago while I was Resident Manager of an independent oil company in Tripoli. The demands of Qaddafi and his colleagues on the Revolutionary Command Council made it readily apparent to those of us who went through the experience that American company control over foreign oil reserves, commercially directed decision making and a highly competitive international market would soon be replaced by hostile government control, politicized decision making and cartelization which would threaten U.S. energy security.

I have over the years then and since, been privileged to serve as an executive of several oil producing companies: Grace Petroleum (a subsidiary of W. R. Grace), Hunt International (controlled by Nelson Bunker Hunt) and Champlin (a subsidiary of Union Pacific Corp.). All three were very substantial producing companies and Champlin was fully integrated as well; however, none were major companies like those whose acquisitions of other companies have prompted these hearings. In short, I am neither a spokesman for "Big Oil" nor have I been indoctrinated with major company attitudes by past experience. Far from it, for an examination of my publications over the years and of my testimony to various Senate Committees, starting with Senator Church's

Multinational Corporation Subcommittee hearings 10 years ago, will reveal that I have never been deterred from criticizing corporate activity which I believe to be contrary to the nation's overall energy security interests.

Having attempted to identify my experience and to set aside any concerns about my impartiality, let me address the relationship between these corporate mergers and national energy security under two headings:

Firstly, do the mergers arise out of a set of underlying circumstances which also constitute a threat to U.S. energy security? And, if so, are the mergers an appropriate or inappropriate response to that energy security threat?

The Underlying Circumstances

In answer to our first question it seems abundantly clear that the recent spate of mergers reflects a number of underlying conditions which threaten energy security far more than they threaten competition:

- **Energy complacency**: It is widely recognized that the acquisitions are only possible because most energy company stocks are vastly undervalued in relation to the value of their underlying resources, whether those resources are oil, natural gas, coal, uranium, nuclear technology, solar collectors or insulation. The reason for this undervaluation is a pervasive complacency which has gripped the entire country ever since the TV commentators and newspaper pundits decided that OPEC's highly publicized difficulty in maintaining control over international oil markets signalled the end -- or at least the beginning of the end -- of OPEC and of the "energy crisis". Politicians and public alike were delighted to embrace the happy projections that a perpetual "oil glut" would soon make oil prices subject to competitive market forces rather than to cartelized government fiat. Many were only too glad to return to the "good old days": the public would no longer have to accept cramped underpowered cars, and the politicians would no longer have to strike those excruciatingly difficult energy development balances with higher costs, air pollution, wilderness usage, environmental risks, radiation fears, price supports, etc. Instead, Congress could refuse to deregulate natural gas, refuse to fund the Clinch River Breeder Reactor, refuse to accept the administration's offshore leasing schedule, refuse to accept responsibility for the completion of for the only surviving large scale synthetic fuel project and refuse to adopt a "least cost approach" to the acid rain problem. In short, it could, with impunity, refuse to accept the risks or costs of almost every domestic development program which could promise realistic reflief from rising oil imports because the pundits had decided that foreign oil would continue to become cheaper and more plentiful. Like the rest of the country, Wall Street demonstrated its infatuation with the perpetual international oil glut thesis by selling-off domestic energy company shares, thereby driving down stock prices.

There can be no basis in reality for the pervasive complacency so long as half of the oil moving in world trade continues to come from the Middle East and North Africa. If that supply is disrupted, curtailed or priced at a higher level, the world price of oil will be bid higher, and our imports will cost more regardless of where they are produced. We need not postulate closure of the Strait of Hormuz, or a kamikaze attack on Ras Tanura or additional terrorist attacks on oil installations in Kuwait in order to raise the prospect of higher prices. Beyond those traumatic events, price increases could be achieved through Arab acceptance of repeated Iranian demands for recission of the $5.00 per barrel reduction engineered by Saudi Arabia a year ago. Consider the possibility of Iran gaining the ascendancy in the Gulf or even being able to maintain the current level of pressure on Iraq and its Arab allies. In either event, some sort of *modus vivendi* will eventually have to be reached if the conflict is ever to end and oil policy is certain to be one element of the negotiations.

- **Declining reserve base**: If recent take-overs have been facilitated by complacency-depressed stock prices of the *acquired* companies, they have been prompted by the depleting oil reserves of the *acquiring* companies. It has been widely reported that Standard Oil of

California (SOCAL), Texaco and Mobil were willing to risk their credit ratings and stock prices because they foresaw a need to secure future oil supplies for their refining and marketing operations. Instead of being criticized for looking beyond the next quarter's earnings report, board room concern about the future viability of their companies ought to become Congress' concern about the future security of the nation. The nation's proven oil reserves are, after all, no more than the sum total of the reserves held by the individual companies so it is hardly surprising that proven American crude oil reserves were estimated by the Oil & Gas Journal to be only 27.3 billion barrels on January 1, 1984. That sounds like an enormous volume of oil until we recognize that the United States produced 3.2 billion in 1983. At that rate, current proven reserves will be consumed in just eight and one half years! Any integrated company that wants to beat the national "mortality rate" will have to acquire future oil for its downstream operations through exploration, import or acquisition.

o **Exploration Barriers**: Of course, additional oil can be found through exploration, and the acquiring companies have a proven track record of risking vast sums in the successful search for it. Still, they know that the pace of exploration is controlled by government policy, for the search requires the availability of new acreage, the generation of retained earnings and the acceptance of environmental risk. The newly strengthened companies will be well placed to generate sufficient earnings and to mobilize acceptable technology for the search in the most promising deep offshore waters. Nonetheless, the Congressional track record over recent years and pending legislation to declare a moratorium on offshore leasing, to raise the so-called Windfall Profits Tax, to reimpose price controls on natural gas and to create new environmental barriers, would certainly prompt prudent managements to consider hedging their bets by also trying to purchase oil reserves to feed their refineries and fuel their customers.

o Import concerns: While I have no first hand knowledge of corporation motivations, I find it striking that Socal, Texaco, and Mobil were all members of the old 4 company ARAMCO consortium, with SOCAL the original concession holder in Saudi Arabia. As such, they know the Middle East well and have better access to its oil than most companies. Therefore, their willingness to risk high debt burdens in order to acquire American reserves instead of relying upon imports may point to a greater appreciation of the true cost of oil imports than that held by Congress. Imports are approaching the levels of 1973 when the ARAMCO companies were required by King Feisal to take a public stand on Middle East policy as the price of continued access to oil. That stand incurred a domestic political cost which most of the companies would not choose to pay again. More recently, they know -- and unsuccessfully resisted for many months -- the cost of having to purchase unwanted quantities of overpriced oil under penalty of future denial. With the Gulf War escalating, American prestige suffering from the Lebanese withdrawal and Iranian influence over OPEC oil policy threatening to rise, the anxiety of these 3 particular companies to reduce their dependence upon Middle Eastern oil may serve as a special warning to the United States to do the same thing.

The Appropriateness of the Response

Turning to our second question, the creation of larger and stronger energy companies strikes me as an entirely appropriate response to the underlying energy security threat which faces the Nation. In stating that position, I start from the generally accepted understanding that immediate concerns about excessive concentration in individual markets can be avoided through FTC-ordered divestiture of offending segments, while longer term concerns about abuse of power will remain under the scrutiny of the antitrust laws. In sum, I believe that the risks to competition are outweighed by the benefits to security. including the following:

- **Mobilization of engineering and R&D capabilities**: Although some may disagree, experience has demonstrated to my own satisfaction that the giant oil companies are singularly well-suited to the exploration and development of those prospects in the deep offshore waters and remote Alaskan areas which hold the greatest hope for huge American oil accumulations. To be entirely candid, I would not make that same observation about the quest for the cumulatively important but smaller discoveries in the lower 48 states where I believe the diversity and risk-taking of 15,000 independent wildcatters improve the prospects for success. But I have observed the OCS to be the "major's game," for there the quest seems less dependent upon innovative development of new "plays" than upon the costly testing and development of huge structures. No one can afford to look for small stratigraphic traps in 1000 feet of water, and the big structural traps should be visible on every company's seismic records. Therefore, success is more dependent upon the development of cost-cutting technology and the mobilization of massive engineering capability. Only the biggest companies can support the necessary R&D and engineering staffs which are required to develop deep water reservoirs. In fact, in many instances, the major companies have pooled their resources in ad hoc consortia to develop offshore prospects, thereby forming informal combinations which have raised concerns among many of the same legislators who now criticize these more formal mergers.

- **Mobilization of capital**: Some have expressed concern that a significant portion of future earnings of the acquired companies will be committed to debt service. This may be true for a period of time, but critics should ask themselves what would have happened to the earnings of Gulf and Superior if their petroleum reserves had been placed in separate royalty trusts as was attempted. Although I was not fortunate enough to own any Gulf or Superior stock, it is my understanding that the principal purpose of such trusts was to channel the earnings directly to royalty unit holders rather than to retain them within the corporation for its integrated operations. While such arrangements are said to benefit the income of sharheolders in some instances, they do not benefit the efforts of horizontally-integrated energy corporations to develop the alternative energy supplies which the Nation requires or of vertically-integrated companies to upgrade their refineries to handle the heavy crude oil which is available from Alaska and Western Hemisphere sources. In short, energy security is not only measured in number of wells drilled.
Moreover, the truly capital intensive phase of frontier petroleum operations is during development, not exploration. The development of North Sea oil fields taught me that project financing is available only to those companies which are viewed as having the

very best research and engineering qualifications. Rightly or wrongly, those capabilities were presumed by international bankers to accompany size.

- **Negotiating strength vis-a-vis OPEC**: It seems almost tautological to observe that the companies which are perceived as having a significant supply alternative are best able to negotiate for incremental supplies from OPEC. Therefore, it seems to me that providing major marketers and refiners with company-controlled American reserves puts them in a better position when they face foreign producers across the table.

Consideration of the Alternatives

Finally, we must recognize that maintenance of the status quo is not a realitic prospect in a dynamic industry. Therefore I believe that Congress must consider the alternatives to permitting the consolidation of oil company assets. Firstly, would the nation's energy security be better served by breaking-up the acquired companies whose assets have been undervalued and board rooms sundered by Wall Street's complacency? After all, those underpriced assets not only provide an attractive investment opportunity for integrated energy companies interested in long term growth and survival, but also present easy prey for so-called raiders interested only in dis-integration and quick profits. It is important to remember that Gulf, the largest and most contentious of the recent acquisitions, was not offered the opportunity to maintain its independent existence but rather to choose between those take-over alternatives. Secondly, would the nation's energy security interests be better served if the acquiring companies were forced to look outside the energy industry to assure their future growth and prosperity? For my part, I would vastly prefer to see Mobil acquire Superior than more mail order stores and packaging companies.

Conclusion

In closing, I would like to commend this committee for refocusing attention on energy security issues; however, I would suggest that the recent mergers do not create a security threat but rather reflect a security threat which arises out of the underlying circustances. Therefore, I hope you will hold hearings which will address those more fundamental concerns.

STATEMENT OF MILTON A. COPULOS, SENIOR ANALYST, ENERGY AND NATURAL RESOURCES, THE HERITAGE FOUNDATION

Mr. Copulos. Senator, thank you. I will be very brief and limit myself to two points. I have some written testimony.

I would like to point out that in the triumph of modern technology pages 1 and 3 are reversed. I would like you to take note of that.

Basically, I think the major point I would like to touch on this morning has been alluded to but not looked at in detail, and that is what the current situation is for a company that is exploring today and what the effect of the various things that Congress has done is on their ability to make profits. Because that is why people go out there, to make profits.

We have seen since 1969 a steady erosion of the financial incentives for looking for oil which has been compounded by price controls on natural gas. So let's just look at a fictional barrel of newly discovered oil. It now takes about $14 to find a barrel of oil according to the latest statistics available from an annual review done on the very largest companies.

That oil is likely to sell for around $28 in today's market. That does not mean, however, that the producer will realize a $14 profit. First, he has to pay a royalty to someone, most often, or in many cases the Federal Government, which is going to take an eighth as a rule. That is $3.50. Then there is the windfall profits tax he is going to wind up paying, which is going to cost him about $3. You need to add to that cost what are called lifting costs, what it costs to get a barrel of oil out of the ground to somewhere where he can use it.

Then States have severance taxes which average around 5 percent or about $1.40 on our fictional barrel of oil. When all is said and done and the various levels of Government have taken their share and the cost of finding it is deducted, he is left with a gross profit of $1.10, of which half will go to the corporate and Federal income taxes, leaving him with about 55 cents a barrel. And that, I would suggest, Senator, is why people are looking on Wall Street rather than in other places for new oil reserves.

When we go beyond that and also start to foreclose the most promising areas where prospective funds might be, including some offshore areas and some areas in Alaska and some areas on Federal lands, it is a small wonder that mergers are taking place and that people are trying to consolidate rather than find new reserves.

Much of the other things I was going to cover have already been covered by other people and I will let my written statement cover the balance.

[The prepared statement of Mr. Copulos follows:]

TESTIMONY

OF

MILTON R COPULOS

BEFORE

THE

SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

APRIL 10, 1984

It is important to note here that the move to merge does not mean that competition will end. In fact, quite the opposite will occur. The new cost-conciousness and efficiencies created through mergers will in the end lead to more, not less competition, because companies which might not have been able to compete at the gasoline pump will now be able to do so. There are still many firms within the industry, unlike others such as automobiles, steel, or food, and they all sell essentially the same product. Therefore, price will be the main method of competition, and that means that the consumer will win.

Efficiency considerations, of course, do not address the other congressional concern: exploration for new supplies. Here, as with the question of how mergers effect competition, we must look beyond the rhetoric, to determine where the truth lies. It is a truth, some of you may not like.

More than any other other factor, it is government policies that have caused the decline in domestic oil exploration. From 1969 on, a series of adverse decisions--made in Congress--have led to a steady erosion of the rewards associated with oil exploration. Given the high risk nature of the business, what is surprising is that the decline in domestic reserves has not been greater than that we have witnessed. Stop and think: first Congress eliminated the depletion allowance for most integrated oil firms, then, it imposed price controls, then, as if to add insult to injury, it enacted the Windfall Profits Tax. At the same time these financial disincentives were being enacted, new costs were being imposed through environmental, health and safety regulations as well.

long trend towards a declining reserve base.

Even while new and more diverse supplies were discovered and developed, however, an even more important factor was making its contribution to the new face of world oil trade: conservation. It took hold with a vengeance, and produced results far exceeding even the most optimistic projections. The net effect of this sudden change in consumption patterns, however, was not just to reduce dependence on OPEC, it also invalidated much of the conventional wisdom that had been the basis for planning in the oil industry throughout the post-war period.

From the end of World War II on, the oil industry had gone through an expansive period, with companies competeing fiercely at the margins for customers, and sales. As a result, both marketing and refining operations were expanded to provide for what appeared to be steadily increasing needs. In the post-embargo period, however, these operations were hit from two sides. First, came the reduction in demand that came from OPEC's gross overpricing of oil, then, came the reduction in profitability which accompanied the inevitable price collapse that followed. Company after company was faced with the same problem, excess refining capacity and too many outlets.

Initial industry reaction was to enter into a period of austerity, closing inefficient operations, selling off surplus stations, and releasing surplus personel. In some cases, personel cutbacks reached 20 percent. Still, even these Draconian moves were not enough . The industry was simply overbuilt. This meant that the only rational move was to consolidate, and combine operations. Hence the mergers.

For months now, a controversy has raged over the series of mergers that have taken place among oil companies. Critics of such moves fear that they signal the advent of undue concentration, higher prices for consumers, and a decline in domestic exploration. While these fears might appear justified on the surface, on closer examination, they are not. The mergers which have taken place, and which are proposed are not really a problem. Rather, they are a response to a problem: the fundamental and profound changes which have taken place in the post-embargo oil market. Therefore, the move to consolidate and streamline the industry through mergers was not only inevitable, but beneficial as well.

In the years since 1973, the world experienced a series of energy disruptions unprecedented in its history. Their net effect, however, was to elicit both a conservation response, and a move to diversify import sources that few could have anticipated. As these effects took hold, the world oil market rapidly took on a new and different shape. OPEC's contribution to Free World oil supplies dropped by half, from two-thirds to about one-third. At the same time, new and prolific oil provinces were discovered and began to come on stream. If you stop and think, the increase in non-OPEC oil exporters since 1973 has been astounding. Mexico--thought to be played out in the late 1960's--increased its production from the new discoveries in its southern regions to the point that it is now the U.S.'s largest supplier. West Africa, the South China Sea, the North Sea, and the Gulf of Thailand all have either begun production or hold great promise. Even the waters off our own coast recently witnessed a major discovery, while increased onshore development led to an arresting of a decades-

Nor were these actions all. The Supreme Court's 1954 decision in the Phillips case insured that natural gas would no longer be attractive, at least for the interstate market, and then Congress compounded the problem with the 1978 NGPA. Recent moves have led to the foreclosing of some of the nations most promising petroleum provinces to exploration and development through environmental restrictions, and there is now talk of imposing an energy tax too. Taken individually, each of these actions might seem to be justifiable, but taken as a whole, they paint a grim picture. How can you expect the industry to engage in high-risk endeavors, without allowing them sufficient rewards? If you take a look at what happens to a company that finds a barrel of oil the out of kilter nature of risks and rewards becomes evident.

It now takes about $14 to find a barrel of oil. That barrel will likely sell for around $28 in today's market. The producer, however, will not realize a $14 profit. First, he must pay a royalty to someone--often the federal government of around one-eigth the selling price. That would come to $3.50 in this case. Then, there is a Windfall Profits Tax of about $3. We then must add lifting costs--what it takes to get the oil out of the ground--of around $5. States take a severance tax of about 5 percent of the selling price, or around $1.40. This leaves the producer with a gross profit of about $1.10, of which half will go to state and federal income taxes, leaving him with a net profit of about 55 cents on that new barrel of oil. Given these figures, don't be surprised when oil companies look for oil on Wall Street, you are making it impossible for them to look for it anywhere else.

If Congress really wants oil exploration to increase, then it should make oil exploration attractive. Restore the depletion allowance to pre-1969 levels. Repeal the Windfall Profits Tax--it just gets passed on to the consumer anyway. Remove restrictions on where companies can look, and repeal the price controls on natural gas. Do these things, and you will witness a renaissance of oil exploration and development beyond your wildest dreams. According to an analysis I and a colleague did a few years back, taking the steps I have just outlined would make the U.S. self-sufficient in natural gas within four years, and oil within seven. Moreover, that self-sufficiency would take place at moderate price levels, and would continue through the end of the century. If you take no action, however, and continue down the current path, shortages, higher prices, and economic disruptions are an inevitability.

In short, when asked what government should do the answer is simple: It should get out of the way.

Senator **Warner**. I thank each of you. You have made a valuable contribution in the past and we thank you for your participation. We hope in the future that will be the case and we thank you.

We have one last witness who wants to testify, Mr. David C. Batten, managing director of First Boston Corp. I understand Mr. Edwin Rothschild would also like to be included.

The balance of the witnesses—the subcommittee will resume at 2:30 and we will hear from those that desire to be heard.

STATEMENT OF EDWIN ROTHSCHILD, ASSISTANT DIRECTOR, CITIZEN/LABOR ENERGY COALITION

Mr. **Rothschild**. Thank you, Mr. Chairman. My name is Edwin Rothschild. I am the assistant director of the Citizen/Labor Energy Coalition, which is a nationwide coalition of over 300 citizen, senior, labor, and church groups working on behalf of its 13 million members for reasonably priced energy supplies.

We very much appreciate the opportunity to testify today on whether or not mergers among the Nation's largest oil companies are in the public interest and whether or not Congress ought to take action which would restrict such mergers.

We believe, based upon evidence available in numerous Government studies, congressional hearings, and court cases, that mergers among the Nation's top 20 oil companies are not in the public interest and should be prohibited. We also believe that the proposed mergers between any of the 20 companies with energy companies whose assets exceed $1 billion ought to be allowed only if it can be shown that such a merger will increase domestic exploration and production, increase competition, and substitute a more efficient management for a less efficient one.

In short, Congress must be concerned with the energy, competitive, and organizational consequences of mega-mergers. In the energy industry, not simply with shareholder concerns, as some in the oil industry would argue.

A number of spurious arguments in defense of oil mergers have been put forward by executives of the major oil companies claiming that mergers increase efficiency, do not lessen competition, help shareholders, and will not reduce exploration, and that legislation delaying or prohibiting such mergers is unfair to the companies which have already announced deals and to the stockholders of the companies, and that the antitrust laws are sufficient to protect markets and consumers. Major oil companies are conducting an all-out lobbying blitz to persuade Congress from delaying or prohibiting these takeovers.

Of course, the companies with the help of the administration have already succeeded in defeating the modest merger moratorium legislation introduced by Senators Johnston, Metzenbaum, and Rudman.

The opposition of companies like Socal, Mobil, and Texaco to antimerger legislation is not surprising. Certainly these companies want to protect their interests. The question Congress must answer is not whether these mergers are in the interest of the companies, which they certainly are, but whether they are in the public interest, which we believe they are not.

When Congress was debating oil decontrol and windfall profits tax legislation, executives of the major oil companies came up to Congress and promised that all the additional revenue generated from decontrol would be spent on looking for more oil and gas in the United States.

But all the additional revenue has not been spent on finding additional oil and gas reserves. In fact, Mr. Chairman, if you look at the most recent annual reports, the 1983 annual report this year, you will find that most of the companies reduced their exploration in development budgets and thereby finding less oil and gas reserves and the reserves are down once again. That is not the commitment the companies made when Congress passed decontrol and when Congress passed various tax benefits as well. Money is going into these kinds of mergers when it should have been going into additional exploration and production.

Today when Congress is considering legislation to curb megamergers, some of the same executives are promising that the newly merged entities will spend as much money on exploration as the unmerged entities would have. Today's promises are as empty and false as their promises in 1979. In fact, at the same time these companies are pressuring Congress to decontrol old gas claiming that higher prices are needed to generate additional revenue for exploration and development, they are also saying that the industry's problem is not a lack of revenue but a lack of drillable prospects. Well, they can't have it both ways.

The truth is that there are both sufficient revenues and a large number of drillable prospects, only the companies now having huge new reserves also have from their point of view fewer prospects to drill.

The companies also insist that anti-merger legislation is not fair to shareholders because it is retroactive. This is absurd. Both management and shareholders are taking risks. They know that the Federal Government through the Federal Trade Commission could simply go to court seeking to enjoin the merger and that Congress could act to prohibit mergers.

One of the important consequences of mergers, as we have come to see recently, is the huge increase in interest rates that resulted when huge demands were made on the markets. A number of esteemed economists, like Henry Kauffman, have pointed out that the reason for the rise in interest rates is due to the heavy demand made by the merging companies. So there are serious consequences for the economy, for small business in higher interest rates, and for the average consumer whose interest costs on small loans go up as well from oil mergers.

The competitiveness of the existing oil industry will be preserved, the chairman of Socal told the Senate Judiciary Committee. Had he been forthright, he would have said that the lack of competition in the oil industry will be reduced even more. The current state of competition in the oil industry is not that great to begin with. I will submit evidence provided by the Energy Information Administration, which shows that in most States across the country, for most fuels, including gasoline, heating oil, diesel fuel, jet fuel, that the top four companies control around 50 percent or more of the market and the top eight 75 percent. That demonstrates there is a serious lack of competition to have so few competitors in the marketplace.

Similarly, where there are more independent refiners selling product into markets, the prices tend to be lower. In those States that have independents or more competitors the prices tend to be lower. These mergers will reduce competitiveness. Competitors will be eliminated from the marketplace. The competitors of offshore oil and gas reserves, the refining business and the wholesaling business, will disappear one way or the other.

Even the FTC's proposal for the Texaco/Getty merger does not require that the spunoff assets be, in fact, bought up by another viable company. So there is no guarantee that even those new assets will be part of the competitive system and the likelihood is that they will disappear because no buyer will be found and Texaco will be that much stronger and the market will be that much weaker.

The antitrust laws are basically good laws and they are designed to prevent such mergers from occurring. Certainly the laws can be improved. The FTC, for example, should be given more time to review mergers, especially at times when it must deal with two or three concurrently. Moreover, Congress could ensure that any divestiture scheme imposed by the FTC be completed before any takeover is allowed. Such changes would be helpful.

The problem, however, is really not with the antitrust laws but with their enforcement. Ever since the days of Assistant Attorney General William Baxter, antitrust law enforcement under this administration has become a mechanism to allow mergers which in previous Republican or Democratic administrations would have been challenged outright.

The Reagan administration has not only taken the antitrust law enforcement cop off the beat, but has put him in the driver's seat of the merger getaway car.

If Congress does not act to either strengthen the current antitrust laws or ban these mergers, it is almost certain that the protrust members of the Federal Trade Commission will allow those mergers to be consummated and the industry to be further consolidated.

The FTC has already issued its preliminary approval of the takeover of Getty Oil by Texaco and is likely to provide similar approval to the proposed merger between Standard Oil of California and Gulf Oil and between Mobil Oil and Superior Oil. All of these mergers must be prohibited, because in addition to misallocating capital and fueling further stock speculation, they will result in increased concentration, a lessening of competition and a greater ability to maintain prices above competitive market levels.

I will stop my testimony there. The rest of the arguments are laid out in the complete testimony. I hope the committee will allow me to submit it for the record.

[The prepared statement of Mr. Rothschild follows:]

Statement of Edwin Rothschild

Assistant Director

Citizen/Labor Energy Coalition

before the

Subcommittee on Energy & Minerals

Committee on Energy and Natural Resources

U.S. Senate

April 10, 1984

Mr. Chairman and members of the Committee. My name is Edwin Rothschild. I am the Assistant Director of the Citizen/Labor Energy Coalition, a nationwide coalition of over 300 citizen, senior, labor, and church groups working on behalf of its 13 million members for reasonably priced energy supplies.

We very much appreciate the opportunity to testify today on whether or not mergers among the nation's largest oil companies are in the public interest and whether or not Congress ought to take action which would restrict such mergers.

We believe, based upon evidence available in numerous government studies, congressional hearings and court cases that mergers among the nation's top 20 oil companies are not in the public interest and should be prohibited. We also believe that proposed mergers between any of the top 20 companies with energy companies whose assets exceed $1 billion ought to be allowed only if it can be shown that such a merger will increase domestic exploration and production, increase competition, and substitute a more efficient management for a less efficient one. In short, Congress must be concerned with the energy, competitive and organizational consequences of mega-mergers in the energy industry, not simply with shareholder concerns, as some in the oil industry would argue.

A number of spurious arguments in defense of oil mergers have been put forward by executives of the major oil companies. Claiming that mergers increase efficiency, do not lessen competition, help shareholders and will not reduce exploration and that legislation delaying or prohibiting such mergers is unfair to the companies which have already announced deals and to the stockholders of the companies and that the antitrust laws are sufficient to protect markets and consumers, major oil companies are conducting an all-out lobbying blitz to prevent Congress from delaying or prohibiting these takeovers. And of course, the companies, with the help of the Reagan Administration, have already succeeded in defeating the modest merger moratorium legislation introduced by Senators Johnston, Metzenbaum and Rudman.

The opposition of Socal, Mobil, Texaco, Gulf and Mesa Petroleum to anti-merger legislation is not surprising. Certainly, these companies want to protect their interests. The question Congress must answer is not whether these mergers are in the interest of the companies which they are, but whether they are in the public interest, which they are not.

When Congress was debating oil decontrol and windfall profits tax legislation, executives of the major oil companies trooped up here and promised that all the additional revenue generated from decontrol would be spent on "looking for more oil and gas in the United States." But, all the additional revenue has not been spent on finding additional oil and gas reserves. Today, when Congress is considering legislation to curb mega-mergers, some of the same executives are promising that the newly merged entities will spend as much money on exploration as the unmerged entities would have. Today's promises are as empty and false as their promises in 1979. In fact, at the same time these companies are pressuring Congress to decontrol old gas claiming that higher prices are needed to generate additional revenue for exploration and devlopment, they are also saying that the industry's problem is not a lack of revenue, but a lack of "drillable prospects." Well, they can't have it both ways. The truth is that there are both sufficient revenues and a large number of drillable prospects, only the companies, now having huge new reserves, also have from their point of view fewer prospects to drill.

The companies also insist that anti-merger legislation is not fair to shareholders because it is retroactive. This is absurd. Both management and shareholders are taking risks. They know that the federal government through Federal Trade Commission could simply go to court seeking to enjoin the merger and that Congress could act to prohibit mergers. These risks were clear when the managements of all the firms involved in the current spate of mergers made their deals. Finally, Congress must have broader economic and social concerns than those of oil company shareholders, the largest of whom are banks, financial institutions and stock speculators. What's good for T. Boone Pickens is not necessarily good for the majority of the nation's citizens.

The competitiveness of the existing oil industry will be preserved, the chairman of Socal told the Senate Judiciary Committee at last week's hearings. Had he been forthright, he would have said that the lack of competition in the oil industry will be reduced even more. The greatest threat to the oil industry and to consumers posed by these huge mergers is the threat to competition. There is little enough competition now. There will be even less if these mergers are consumated.

The antitrust laws are good laws and are designed to prevent such mergers from occuring. Certainly these laws can be improved. The FTC, for example, should be given more time to review mergers, especially at times when it must deal with two or three concurrently. Moreover, Congress could insure that any divestiture scheme imposed by the FTC be completed before any takeover is allowed. Such changes would be helpful. The problem, however, is really not with the antitrust laws, but with their enforcement. Ever since the days of Assistant Attorney General William Baxter, antitrust law enforcement under this Administration has become a mechanism to allow mergers which in previous Republican or Democratic Administrations would have been challenged. The Reagan Administration has not only taken the antitrust law enforcement cop off the beat, but has put him in the driver's seat of the merger getaway car.

If Congress does not act to either strengthen the current antitrust laws or ban these mergers, it is almost certain that the pro-trust members of the Federal Trade Commission will allow these mergers to be consummated and the industry to be further consolidated.

The FTC already has issued its preliminary approval of the takeover of Getty Oil by Texaco, Inc. and is likely to provide similar approval to the proposed merger between Standard Oil of California and Gulf Oil and between Mobil Oil and Superior Oil. All of these mergers must be prohibited, because, in addition to misallocating capital and fueling further stock speculation, they will result in increased concentration, a lessening of competition and a greater ability to maintain prices above competitive market levels.

MERGERS MISALLOCATE CAPITAL

In our view mergers among the nation's largest oil companies are not in the public interest. While such mergers certainly benefit the stockholders -- primarily large banks and financial institutions -- of the acquired firm; [1] the Wall Street arbitragers who make lots of money speculating on the increased value of the stock; the financial consultants, lawyers and accountants, whose technical expertise is handsomely compensated; [2] and of course, the acquiring company which obtains vast new assets, the rest of the country pays.

These mergers misallocate billions of dollars, because money is not being spent on productive investments. As Nobel Prize winning economist Wassily Leontief has observed mergers do not produce "new assets or new jobs -- nothing is added to the

---

1. According to The Wall Street Journal, March 7, 1984, at least 63 percent of Gulf shares are held by stock speculators and institutional investors. The group led by T. Boone Pickens, for example, holds 21.7 percent, arbitragers have 20 percent and the Mellon Bank has nearly 10 percent of the stock.

2. Reported transaction fees for the DuPont/Conoco merger were over $42 million and nearly $38 million for the U.S. Steel/Marathon merger.

economy." Money raised to finance mergers or to defend against hostile mergers is money not available for other uses. As The New York Times reported regarding the mergers taking place in 1981,

> According to the Federal Reserve Board, $47 billion in lines of credit were extended for acquisitions by banks in the United States in the last half of 1981 alone. The Fed estimates that $20 billion to $21 billion of those takeover loans were actually drawn down, an amount that equalled the increase in total business loans in the United States between June and December 1981.
>
> These huge loan commitments, made at a time of tight monetary policy, tend to drive up interest rates because, as several banking studies have shown, banks with such commitments lose the flexibility to ration credit and thus must restrict borrowing by raising rates. [3

The large credit needs for the proposed Texaco/Getty, Socal/Gulf and Mobil/Superior mergers has, to be sure, contributed to the most recent rise in the prime rate.

Indeed, money will have to be spent by Mobil, Socal and Texaco to repay the loans incurred for their $30 billion takeovers. This may sharply reduce the money spent on drilling for new reserves, particularly in view of the fact that their newly acquired reserves are so plentiful. Between 1978 and 1982 Standard of California, for example, discovered the equivalent of 602 million barrels of oil and gas in the United States. By acquiring Gulf they not only obtained 1.4 billion barrels of oil and natural gas in the U.S., but also over 2 billion tons of coal and large quantities of other mineral resources and nearly 13 million acres of potential oil and gas producing leases in the

---

3. The New York Times, May 3, 1982. See also, "Letters," The New York Times, January 10, 1982:

> Estimates published in The Times in August would indicate that the amount of bank credit used for acquisitions in 1981 will equal or exceed $70 billion. So, if bank credit for mergers had been cut off in 1981, the effect on the money markets would have been the same as balancing the Federal budget for the year.

U.S. alone. Oil analyst Paul Mlotok of Salomon Brothers also believes that the merged entity will spend less on exploration than the separate companies would have spent. As a result, he believes "Eventually this trough in exploration would lead to a trough in production, which would work to OPEC's benefit."[4] This view was also echoed by the Petroleum Intelligence Weekly, which said, "The overriding implication of escalating United States oil industry takeover battles seems to be reduced investment in exploration and, in the long run, a likely increase in US dependence on foreign supplies."[5]

Even the former chairman of Standard Oil of Indiana agrees that these large mergers may mean a reduction in the amount of money spent on exploration by newly combined entity. "I think some industry revenues will be diverted from that purpose to pay off the debt. But when the debt is paid down--it may take five or ten years--then you'll have a stronger company, which may in the long run do more drilling."[6] That is not the kind of positive response Swearingen has been known for. In fact, it reinforces the concern expressed by many Members of Congress that these mergers are contrary to what the oil industry promised in return for oil and natural gas decontrol.

WHERE'S THE PAYOFF FROM OIL DECONTROL?

When Congress was considering President Carter's decision to phase out price controls on domestically produced crude oil and whether or not to impose a windfall profits tax, oil industry executives argued vehemently in opposition to the tax and in favor of decontrol. They said that the money generated from decontrol was desperately needed to support increased exploration. In May 1979 the former chairman of Gulf Oil, Jerry McAfee, told the House Ways and Means Committee that "the industry will spend any increased earnings from decontrol in the continued search for energy in the United States." Three years later Charles DiBona, the head of the American Petroleum Institute, in his criticism of the windfall profits tax went so far as to say that the revenues generated by decontrol and "retained by producing companies will fall far short of their future needs, even without additional taxes."[7]

---

4. Oil & Gas Journal, February 27, 1984.

5. PIW, March 12, 1984.

6. The New York Times, March 11, 1984.

7. Testimony before the Committee on Interstate and Foreign Commerce, House of Representatives, May 16, 1982.

Oil decontrol, which was estimated to cost consumers about $50 billion for the 1979-1981 period,[8] provided the major oil companies with far more income than they needed or were willing to invest in increased expenditures for domestic exploration and production. This is clearly demonstrated by comparing what happened in the three years prior to decontrol with the three years following decontrol.

In the three years following decontrol (1979-1981), the nation's 16 largest oil companies increased their exploration and production earnings by 147 percent compared to the three years prior to decontrol. Yet, over the same period these companies raised their spending on exploration and production by only 115 percent while increasing their expenditures on mergers and acquisitions by 600 percent. [9]

While some may argue that an increase of 115 percent is large, this rate of increase fell far short of the rate of increase for profits. "The oil exploration business (is) more profitable than any other segment of American industry," according to Merrill Lynch in 1982. Thus, it is particularly surprising that the companies did not invest at a rate in excess of their earnings. The reason is that decontrol (even with a Windfall Profits Tax) generated far more capital than the companies have been able or willing to invest. The companies spent as much of their

---

8. "The Energy Inflation Crisis: Sources, Consequences, and Policy Options," Report by the Subcommittee on Oversight and Investigations of the Committee on Interstate and Foreign Commerce, House of Representatives, December 1980.

9. "Spending the Windfall: An Analysis of Post-Decontrol Oil Company Acquisitions and Investments," A Research Report by the Citizen/Labor Energy Coalition, June 1982.

10. Cash flow is the funds a firm has available to it to make investments and to pay dividends to shareholders. Cash flow consists of profits, other funds generated by operations (e.g. deferred taxes and depreciation), and capital raised by borrowing money or issuing stock. Cash flow, not profits, is the measure financial analysts and economists use to evaluate the investments and performance of companies.

In comparing the two three-year periods, the total cash flow available to the 16 top oil companies increased by $77.1 billion (from $84.1 billion in the 1976-78 period to $161.2 billion in the 1979-81 period). Of this $77.1 billion of marginal cash flow, $26.7 (35%) was used for acquisitions and non-petroleum investment.

increased cash flow [10] to acquire competitors, other industrial firms and non-petroleum activities, as they spent on U.S. exploration and production.

It is interesting to note that today, when public discussion is centered on the social and economic utility of large oil company mergers, oil company executives do not discuss the need for more revenue to expand drilling efforts and to make the U.S. less dependent on foreign oil. Instead, we are told that there is plenty of capital available for drilling, but that what is unavailable are, according to T. Boone Pickens, "drillable prospects." [11]

What they say when they testify on mergers is sharply different from what they say when they testify in favor of natural gas decontrol. Only a year and a half ago Nicholas Bush, President of the Natural Gas Supply Committee, told this Committee that "The increased revenue from natural gas deregulation will be used to allocate additional capital to exploration and production programs aimed at development of new drilling opportunities and additional production from old reservoirs." If this is true, Mr. Chairman, then why are the companies not spending their increased revenue from partial natural gas decontrol on more gas drilling? Almost all of the major oil companies' annual reports show a sharp drop in domestic exploration expenditures and a parallel drop in reserve additions. Clearly, decontrol has not worked as promised. On the contrary the companies are using decontrol revenues for purposes of industrial consolildation, not resource expansion.

Bankrolled by the billions of dollars from oil decontrol and the partial decontrol of natural gas, the merger mania sweeping through the oil/energy industry is also being driven by several other factors, including lax antitrust enforcement, federal tax incentives, riskless reserve additions, stock speculation, and the further reduction of competition.

Lax Antitrust Enforcement

The Federal Trade Commission has signalled its intention to allow mergers between large competitors in the petroleum industry, despite evidence demonstrating such mergers will be anti-competitive and despite growing congressional, industry and consumer opposition. Moreover, the Secretary of Energy has stated publicly that the top 20 companies are "very big, big companies, very capable of competing," and that "the mergers don't seem to me to be cutting across that significantly." [12]

---

[11] The MacNeil/Lehrer News Hour, March 6, 1984.

The revised merger guidelines issued when William Baxter was in charge of the Justice Department's Antitrust Division was the Administration's signal to companies, who had previously resisted the temptation for fear of vigorous antitrust enforcement, that their merger proposals would probably meet with Administration approval. Baxter rewrote the merger guidelines because he believed that the government should allow mergers "which promote efficiencies." [13]

Baxter was even more specific regarding oil industry mergers in an August 1981 interview. He said that there was a surge of merger activity among oil companies because the companies "are flush with cash...and they're looking for effective ways to deploy large holdings." He stated further that the Reagan Administration's antitrust policy "is different from that of previous administrations, and people are contemplating mergers that they would have been somewhat more bearish about before." In response to a question asking if there were some contemplated mergers that companies would not have considered in the past, Baxter said, "Mobil Corporation's tender offer for Conoco might fall into that category. If Texaco makes an offer for Conoco, I would put that in the same class." Baxter also told potential merger candidates that if there were areas of "horizontal overlap," the merger could be "saved by pruning one or the other of the partners, carving out a subsidiary prior to the merger." [14]

The Federal Trade Commission adopted Baxter's new theoretical and permissive posture to large mergers, when it ruled favorably on Mobil's attempt to acquire Marathon Oil and approved the takeover of Getty Oil by Texaco. While the FTC required Texaco to divest certain refining, marketing and transportation assets and

---

12. The New York Times, March 11, 1984

13. Confirmation Hearing on William F. Baxter, Nominee, to be Assistant Attorney General -- Antitrust Division, Committee on the Judiciary, United States Senate, 97th Cong., 1st Sess., March 19, 1981, p. 59.

14. U.S. News & World Report, August 3, 1981

to make a commitment to continue to supply certain Getty customers upon completion of the merger, this remedy does more harm than good. The Commission permits Texaco to retain all of Getty's crude oil and natural gas reserves, its crude oil gathering systems, its large East Coast refinery and other assets most desired by Texaco. It requires Texaco to divest a Getty refinery in El Dorado, Kansas and Getty's interest in a pipeline which delivers refined products from the Kansas refinery to markets in Colorado. Under the FTC arrangement, however, Texaco has no obligation to supply this refinery with oil. As a result, there is a good chance this refinery will be shut down, leading to reduced competition in the markets it serves. In California, the FTC's proposal requires Texaco to sell crude oil at the "posted price" for a period of five years to independent refiners. FTC Commissioner Michael Pertschuk in his dissent from the Commission's decision explained how Texaco will still be able to manipulate supplies and prices in the California market. [15] It was precisely this kind of outcome that enforcement of the antitrust laws was supposed to prevent.

Federal Tax Incentives

The tax consequences of mergers are significant. Depending on the type of acquisition, how it is being financed and how the shareholders of the acquired firm are compensated, the U.S. tax code may provide tax-related benefits to the combined firm. In 1982 the Federal Trade Commission observed that "The ability to step up the basis of an acquired firm can provide a substantial incentive for merger by allowing the combined firm to redepreciate assets and reduce tax liabilities." [16] And Robert J. Samuelson recently pointed out that "When profitable companies borrow, they deduct interest costs from their taxes, which -- because the top corporate tax rate is 46 percent -- means the true interest rate is about half the market level." [17]

As part of any legislative proposal dealing with these mergers,

---

15. In the Matter of Texaco Inc. and Getty Oil Company, "Agreement Containing Consent Order," File No. 841-007, Federal Trade Commission, February 13, 1984

16. Mergers in the Petroleum Industry, A Report of the Federal Trade Commission September 1982, p. 80

17. The Washington Post, March 14, 1984.

RESERVES FOUND VERSUS RESERVES BOUGHT
(In Barrels and Dollars)

Reserves (MBOE)			TEXACO				GETTY
	1978	1979	1980	1981	1982	5-Year	1984
Drilling	135	74	66	80	92	447	
Imp. Recov.			106			106	
Total	135	74	172	80	92	553	1640
Costs (Mill. $)							
Prop. Acq.	29	101	474	291	471	1366	
Expl.	144	262	352	611	820	2189	
Devel.	476	445	595	804	698	3018	
Total	649	808	1421	1706	1989	6573	10100

			SOCAL				GULF
Reserves	1978	1979	1980	1981	1982	5-Year	1984
Drilling	75	81	93	89	76	414	
Imp. Recov.	66	45	21	40	16	188	
Total	141	126	114	129	92	602	1446
Costs							
Prop. Acq.	95	229	136	841	176	1477	
Expl.	263	381	751	835	723	2953	
Devel.	301	438	647	934	911	3231	
Total	659	1048	1534	2610	1810	7661	13200

			MOBIL				SUPERIOR
Reserves	1978	1979	1980	1981	1982	5-Year	1984
Drilling	78	64	94	117	75	428	
Imp. Recov.	0	0	0	0	0	0	
Total	78	64	94	117	75	428	447
Costs							
Prop. Acq.	185	487	404	383	447	1906	
Expl.	163	248	378	633	712	2134	
Devel.	395	345	417	516	608	2281	
Total	743	1080	1199	1532	1767	6321	5700

Source: "A U.S. Oil Industry Study," Tenneco.

Congress ought to couct a thorough examination of the tax implications and consequences of these and other mergers. To what degree are other American taxpayers helping to finance these multi-billion dollar deal?

Acquiring Riskless Reserves

The major oil companies recognize that while the costs of finding oil through drilling may be comparable to the costs of buying reserves through acquisition, [18] the risks are quite different. There is very little uncertainty in buying known quantities of already discovered reserves. There is a great deal of uncertainty in exploring for large fields, as the recent experience with the Mukluk well in Alaska demonstrates.

Large oil companies are interested in obtaining large reserves of oil and gas. Finding such reserves through acquisition does not require years of exploratory work. It also guarantees a one hundred per cent success rate. The table below indicates that between 1978 and 1982 Texaco found the equivalent of 553 million barrels of oil in the U.S. and spent $6.6 billion. By acquiring Getty it obtains, in addition to all of Getty's other assets, 1.6 billion barrels, three times the amount it found over a five-year period. Over the same period Socal found 602 million barrels and spent $7.7 billion. By acquiring Gulf, Socal obtains more than twice the reserves -- over 1.4 billion barrels -- than it found. Mobil's purchase of Superior nets it slightly more reserves -- 447 million barrels -- than it found over the 1978-82 period -- 428 million barrels.

Undervalued Stocks

Because stock speculators believe in making short-term profits, while oil company managements believe in long-term profit maximization, and because there often can be a substantial discrepancy between the value of an oil company's underlying assets and the stock price reflecting those assets, a number of oil companies have become vulnerable to takeovers. The exploitation of this difference allows stock speculation and the kind of management panic so effectively promoted by T. Boone Pickens.

---

[18] One recent analysis even concluded that "it is less costly to acquire a BOE (barrel of oil equivalent) by drilling than by acquisition." "The Cost of Reserves By Discovery vs. Acquisition," James C. Dyer, Oil & Gas Journal, December 19, 1983.

According to Pickens, a number of major companies are wasting their huge cash flows from previous discoveries to finance exploration for more costly and difficult to find reserves, on non-oil investments like Exxon's acquisition of Reliance Electric and on subsidizing unprofitable refining and marketing operations. This is why, according to Pickens and others, a number of companies are price around 40% of their asset value. [19]

Executives of the major companies, says Gulf Oil's chairman James Lee, "have to be concerned about the long-term viability" of their corporations. [20]

No matter whose strategy is correct, the end result of this wasteful clash corporate and financial muscle is the further consolidation of the industry in fewer hands. A restriction or prohibition on merger activity would freeze on any more efforts by Pickens and others to make hundreds of millions of dollars in the stock market manipulation, which some observers have suggested is Pickens' real intent.

Reduced Competition

The elimination of a large competitor from the ranks of the oil industry provides the acquiring company with more control over the price it can charge for its products. With increased concentration of ownership and control over production, transportation, refining and marketing, the largest companies in the industry will be in an even stronger position to limit competition from independent refiners and marketers.

Consumers lose when competition is reduced, because prices will be established and maintained at levels above those obtaining in a competitive market. Increased control over geographic and

---

19. Fortune, December 26, 1983

20. Business Week, November 14, 1983.

product markets by fewer firms means that consumers of gasoline, heating oil and other products will be forced to pay excessively high prices.

THE ANTI-COMPETITIVE STRUCTURE OF THE DOMESTIC OIL INDUSTRY

Unlike the Federal Trade Commission, the U.S. Court of Appeals for the Sixth Circuit in 1981 blocked Mobil's proposed merger with Marathon Oil on antitrust grounds. In its ruling the Court cited evidence demonstrating "that the oil industry is characterized by a complex set of close working relationships; joint ventures for crude oil exploration and production; joint operation of pipelines and transportation; exchange agreements under which the companies swap among themselves crude oil and refined products..." [21] The "complex set of close working relationships" is nothing new. It has characterized the structure and operation of the major oil companies since the breakup of the Standard Oil Trust in 1911.

For example, evidence compiled before the Temporary National Economic Commission, set up by Congress in 1938 to conduct a study of the concentration of economic power in American industry and the effect of that concentration upon the decline in competition, found concentration in the oil industry high at every level. Congressional investigations by the Antitrust and Monopoly Subcommittee under Senator Estes Kefauver and Senator Philip Hart provided continuing evidence that the oil industry, both domestically and internationally, was not workably competitive.

In 1973 the Federal Trade Commission filed an antitrust complaint against the eight largest oil companies. Although the Reagan Administration put an end to the litigation, the Commission staff through the discovery process obtained a vast number of industry documents showing that the companies engaged in "a common course of action, the ultimate purpose of which was to maintain and reinforce the noncompetitive market structure at every level of the petroleum industry." [22]

The FTC staff concluded that among the effects of the companies' actions were:

---

21. 669 Fed. 2nd 378, December 23, 1981

22. In Re:Exxon, et. al., Docket No. 8934, "Complaint Counsel's First Statement of Issues, Factual Contentions and Proof, October 31, 1980.

> 1) the establishment and maintenance of artificially high price levels for both domestic and foreign crude oil;
>
> 2) foreclosure and suppression of actual and potential competition in the refining and marketing segments of the industry (accomplished, in part, by the respondents uniform exploitation of their ownership of pipelines to control supply and distribution of crude oil and refined products); and ultimately
>
> 3) the payment of substantially higher prices by American consumers for refined petroleum products than they would have paid in a competitively structured market.

Even former Assistant Attorney General William Baxter concluded that,

> ...between 1974 and 1979 the Saudis, either directly or in conjunction with the Aramco partners (Exxon, Socal, Texaco and Mobil), were able, by adjusting their output, to prevent significant fluctuations in the world price of oil despite a significant recession, high inflation and a substantial increase in non-OPEC production capacity.[23]

Baxter also concluded that the Aramco partners in 1975 may have restricted Saudi crude production "for anticompetitive reasons." The ability of the Aramco partners to withhold Saudi output, said Baxter, "could have cost U.S. consumers in excess of $1 billion annually."

These findings are not unique. The results of the Canadian Government's investigation, "The State of Competition in the Canadian Petroleum Industry," found that the multinational petroleum companies "that dominate the Canadian industry have used various restrictive practices to develop, protect, and exploit their monopolistic situation in Canada."[24] Based on this investigation, the staff of Canada's Restrictive Trade Practices Commission filed an 800-page report which calculated consumer overcharges of $3.2 billion from 1958 to 1973, adjusted for inflation. According to The New York Times, "The report is the broadest investigation of the oil business ever undertaken in

---

23. "Memorandum for the Attorney General, Re: Termination of the Antitrust Division's International Oil Investigation," December 7, 1983

24. Volume I, Findings, Issues and Remedies, February 27, 1981, p. 35.

the world." [25]

The basic problem with the domestic oil market is that sufficient competition is lacking at most industry levels and in many geographic areas of the country. Large mergers will even further reduce competition.

THE CRUDE OIL MARKET

Even though the market for crude oil is international and even though major international oil companies no longer own oil resources in most of the OPEC countries, they are still among the largest producers and buyers of oil worldwide. The major international oil companies still produce their own crude oil in the United States, Canada, the North Sea and several other countries. In some OPEC countries, the major oil companies still produce equity oil [in Indonesia and Nigeria]. In most other OPEC countries, the majors have contracts to purchase the output, or, as in the case of Saudi Arabia, are virtually the sole purchasers. This combined producing and purchasing power still provides the majors with the ability to allocate supplies and with OPEC manage production.

At the beginning of 1983 in the United States the top 8 oil companies owned about 44 percent of the nation's oil reserves and 39 percent of oil production (See Tables I and III). If the mergers between Texaco/Getty, Socal/Gulf and Mobil/Superior are permitted, the largest eight companies will own 50 percent of the reserves and 45 percent of production. But these figures vastly understate the real control these companies exercise over rerserves and production.

The Federal Trade Commission has reported:

> In general, petroleum firms do not own the land on which they produce oil. Instead, the producer typically enters into an oil and gas lease, which allows the oil producer to drill wells on the land and recover the crude oil [or natural gas] found. As payment for this concession, the producer will customarily assign the landowner a royalty share (usually 1/8) of the crude oil produced. Because the landowner is not normally a participant in the petroleum industry, this share will most often be taken in cash. Thus, in the most common arrangement of this type, for every seven barrels reported as a part of the firm's owned

---

25. The New York Times, February 23, 1984

> production, an additional barrel of royalty oil will be under the control of the firm for purposes of sale or other disposition. To the extent that royalty oil is excluded from reported production, market share figures for leading firms could be understated by as much as 14 percent.[26]

Thus, adjusting the top 8 companies share by 14 percent results in pre-merger concentration of 51 percent and post-merger concentration of 57 percent. But, the FTC found that control is also exercised through the ownership of gathering lines which "may enhance to some degree the market power held by the larger firms." [27] A Congressional committee staff study found that in 1974, in Texas, the 20 largest oil companies together gained physical control through gathering of an additional amount of crude oil equivalent to 13.1 percent of their Texas production. [28]

It is interesting to note that the above-cited FTC study on petroleum industry mergers concluded that "These arrangements, consisting of crude oil joint bids for federal and state oil and gas lands, joint drilling ventures, crude exchanges, ownership of crude gathering and transportation systems, should therefore be examined in assessing the impact of particular mergers on competition." So far, in reviewing the Mobil/Marathon merger in 1981 or the Texaco/Getty merger this year, the Commission has failed to examine these arrangements and the impact the proposed mergers would have at the level of crude oil production.

Tables II and IV show the changes in concentration levels for natural gas reserves and natural gas production, respectively. This data, however, is not relevant to an analysis of competition in the sale of natural gas, because most of the nation's gas reserves are committed to long-term contracts and are thus not part of "the market." As of December 31, 1982 21.5 Tcf of natural gas reserves were uncommitted and 152.2 Tcf were committed. In analyzing the producer natural gas market, the Committee ought to obtain market share data of uncommitted gas reserves on both a national and producing area basis.

---

26. "Mergers in the Petroleum Industry," Report of the Federal Trade Commission, September 1982, p. 159.

27. Ibid., p. 160.

28. Subcommittee on Monopolies and Commercial Law, Committee on the Judiciary, House of Representatives, 96th Cong., 1st Sess.,"Interdependence in Domestic Crude Oil Joint Ventures, Farm Outs, Exchanges, and Gathering Lines," 1979.

OIL PIPELINES

In addition to their control over most of the crude oil gathering lines, the major companies also control, individually and jointly over 91 percent of crude oil and petroleum products shipped through the nation's large-diameter pipelines. The major companies accounted fr ownership of over 74 percent of total pipeline mileage. Bec of this control, concentration of oil shipments in regional keting areas is very high. Table VIII identifies four of ation's largest and most important pipelines and their

In its 1982 Merge the FTC concluded,

Because of the potentia, economies of scale of certain pipelines, the possibility of market power exists. The degree of such market power will often depend on the size of the pipeline, which may confer unique competitive advantages upon it in comparison with other, smaller pipelines or alternative modes of transportation in a given service area (p. 246). Even though pipelines are supposed to be regulated, the Federal Energy Regulatory Commission has utterly failed to do its job. Just a few days ago a unanimous Court of Appeals for the D.C. Circuit in remanding the FERC's Williams Pipe Line case back to the Commission ruled that the FERC failed "to ensure that oil pipeline rates are "just and reasonable." [29] In its analysis of the Texaco/Getty merger, the FTC staff found that the Colonial pipeline estimated it had a 20.22 percent return on equity for 1983, a rate of return far in excess of what a Commission concerned about "just and reasonable" rates would allow.

REFINING AND MARKETING

Concentration in the refining and marketing sectors of the oil industry are also extraordinarily high. As Tables V - VII show, the s la

---

29. Slip Op. No. 82-2412.

REFINING AND MARKETING

Concentration in the refining and marketing sectors of the oil industry are also extraordinarily high. As Tables V - VII show, the largest 8 refiners prior to the mergers already own 59%, 84% and 73% of the Gulf Coast, East Coast and West Coast markets, respectively. In combination with their ownership over the most efficient transportation modes, these companies also control the wholesale and retail sales of products such as gasoline and heating oil. Table IX, taken from a July 1979 DOE study entitled "Middle Distillate Market Profile Report" supports the view that in the key markets, eight companies produce and sell between 60% and 100% of middle distillate fuel. Similar information on regional control over wholesale and retail gasoline sales is apparently in the hands of the Energy Information Administration of the Department of Energy.

CONCLUSION

Based on this evidence of high concentration at every level of the oil industry combined with the vast network of joint venture relationships and vertical integration, one can only conclude that competition is minimal in the petroleum industry and that new mergers among the largest firms can only make a bad situation worse.

TABLE I
1982 U.S.LIQUIDS RESERVES
Thousands of Barrels

PRE-MERGERS			POST-MERGERS		
COMPANY	RESERVES	PERCENTAGE	COMPANY	RESERVES	PERCENTAGE
SOHIO	2855600	0.081	SOHIO	2855600	0.081
EXXON	2836000	0.081	EXXON	2836000	0.081
ARCO	2561000	0.073	ARCO	2561000	0.073
SHELL	2200000	0.063	TEXACO/GETTY	2246000	0.064
STD.INDIANA	1660000	0.047	SHELL	2200000	0.063
GETTY	1241000	0.035	SOCAL/GULF	2018000	0.058
SOCAL	1202000	0.034	STD.INDIANA	1660000	0.047
TEXACO	1045000	0.030	MOBIL/SUPERI	1044690	0.030
MOBIL	906000	0.026	SUN	691000	0.020
GULF	816000	0.023	MARATHON	606289	0.017
SUN	691000	0.020	UNION	523000	0.015
MARATHON*	606289	0.017	PHILLIPS	492000	0.014
UNION	523000	0.015	CONOCO	350000	0.010
PHILLIPS	492000	0.014	OCCIDENTAL	275000	0.008
CONOCO**	350000	0.010	AMERADA HESS	260000	0.007
OCCIDENTAL***	275000	0.008	TENNECO	251181	0.007
AMERADA HESS	260000	0.007	CHAMPLIN	152900	0.004
TENNECO	251181	0.007	PENNZOIL	140000	0.004
CHAMPLIN	152900	0.004	SANTA FE	138300	0.004
PENNZOIL	140000	0.004	MITCHELL	125899	0.004
TOP 4	10452600	0.298		10498600	0.299
TOP 8	15600600	0.444		17421290	0.497
TOP 16	20259889	0.577		20869760	0.595
TOP 20	21063970	0.599		21426859	0.611
TOTAL US	35079000				
	11915964	0.340		11968404	0.341
	17784684	0.507		19860271	0.566
	23096273	0.658		23791526	0.678
	24012926	0.685		24426619	0.696

* Acquired by U.S. Steel.
** Acquired by DuPont.
*** Acquired Cities Service.

Source: Oil & Gas Journal, October 17, 1983.

TABLE II
1982 U.S. NATURAL GAS RESERVES
Billions of Cubic Feet

PRE-MERGERS			POST-MERGER		
COMPANY	RESERVES	PERCENTAGE	COMPANY	RESERVES	PERCENTAGE
EXXON	16461	0.078	EXXON	16461	0.078
ARCO	14438	0.069	ARCO	14438	0.069
STD.INDIANA	9009	0.043	STD.INDIANA	9009	0.043
SHELL	7290	0.035	SOCAL/GULF	8947	0.043
SOHIO	6391	0.030	TEXACO/GETTY	8643	0.041
MOBIL	6334	0.030	MOBIL/SUPERI	8189	0.039
TEXACO	6247	0.030	SHELL	7290	0.035
UNION	5170	0.025	SOHIO	6391	0.030
SOCAL	5046	0.024	UNION	5170	0.025
GULF	3901	0.019	PHILLIPS	3432	0.016
PHILLIPS	3432	0.016	TENNECO	3207	0.015
TENNECO	3207	0.015	SUN	3148	0.013
SUN	3148	0.015	OCCIDENTAL	2747	0.011
OCCIDENTAL	2747	0.013	CONOCO	2303	0.011
GETTY	2396	0.011	CHAMPLIN	2021	0.010
CONOCO	2303	0.011	MARATHON	1891	0.009
CHAMPLIN	2021	0.010	PANHANDLE	1333	0.006
MARATHON	1891	0.009	TEXAS O&G	1253	0.006
SUPERIOR	1850	0.009	COASTAL	1059	0.005
PANHANDLE	1333	0.006	NORTHWEST	1050	0.005
TOP 4	47198	0.224		48855	0.232
TOP 8	71340	0.339		79368	0.377
TOP 16	97520	0.463		103287	0.491
TOP 20	104615	0.497		107982	0.513
TOTAL US	210512			210512	
	53806	0.255		55695	0.265
	81328	0.386		90480	0.430
	111173	0.528		117747	0.559
	119261	0.567		123099	0.585

Source: Oil & Gas Journal, October 17, 1983.

TABLE III
1982 U.S. LIQUIDS PRODUCTION
Thousands of Barrels

PRE-MERGER			POST-MERGER		
COMPANY	PRODUCTION	PERCENTAGE	COMPANY	PRODUCTIO	PERCENTAGE
EXXON	270000	0.074	EXXON	270000	0.074
SOHIO	253200	0.069	SOHIO	253000	0.069
ARCO	222000	0.060	TEXACO/GETTY	229000	0.062
SHELL	190000	0.052	SOCAL/GULF	225000	0.061
STD. INDIANA	151000	0.041	ARCO	222000	0.060
TEXACO	127000	0.035	SHELL	190000	0.052
SOCAL	121000	0.033	STD. INDIANA	151000	0.041
GULF	104000	0.028	MOBIL/SUPERI	123787	0.034
MOBIL	103000	0.028	SUN	78000	0.021
GETTY	102000	0.028	MARATHON	58431	0.016
SUN	78000	0.021	UNION	55000	0.015
MARATHON	58431	0.016	PHILLIPS	50000	0.014
UNION	55000	0.015	CONOCO	50000	0.014
PHILLIPS	50000	0.014	TENNECO	34897	0.010
CONOCO	50000	0.014	AMERADA HESS	28000	0.008
TENNECO	34897	0.010	CHAMPLIN	21681	0.006
AMERADA HESS	28000	0.008	SANTA FE	16300	0.004
CHAMPLIN	21681	0.006	MITCHELL	16252	0.004
SUPERIOR	20787	0.006	LA. LAND	15100	0.004
SANTA FE	16300	0.004	AMINOIL*	14468	0.004
TOP 4	935200	0.255		977000	0.266
TOP 8	1438200	0.392		1663787	0.453
TOP 16	1969528	0.537		2039796	0.556
TOP 20	2056296	0.560		2101916	0.572
U.S. TOTAL	3671000			3671000	
	1066128	0.290		1113780	0.303
	1639548	0.447		1896717	0.517
	2245262	0.612		2325367	0.633
	2344177	0.639		2396184	0.653

Source: Oil & Gas Journal, October 17, 1983.

TABLE IV
1982 U.S. NATURAL GAS PRODUCTION
Millions of Cubic Feet

PRE-MERGER			POST-MERGER		
COMPANY	PRODUCTION	PERCENTAGE	COMPANY	PRODUCTION	PERCENTAGE
EXXON	1035000	0.059	TEXACO/GETTY	1097000	0.063
TEXACO	778000	0.044	EXXON	1035000	0.059
STD. INDIANA	699000	0.040	SOCAL/GULF	948000	0.054
SHELL	607000	0.035	MOBIL/SUPERIO	874000	0.050
MOBIL	606000	0.035	STD. INDIANA	699000	0.040
GULF	525000	0.030	SHELL	607000	0.035
ARCO	470000	0.027	ARCO	470000	0.027
SOCAL	423000	0.024	UNION	403000	0.023
UNION	403000	0.023	TENNECO	390268	0.022
TENNECO	390268	0.022	SUN	321000	0.018
SUN	321000	0.018	PHILLIPS	274000	0.016
GETTY	319000	0.018	CONOCO	262000	0.015
PHILLIPS	274000	0.016	PENNZOIL	168000	0.010
SUPERIOR	268000	0.015	TEXAS O&G	133823	0.008
CONOCO	262000	0.015	MARATHON	132977	0.008
PENNZOIL	168000	0.010	CONSOL NG	122000	0.007
TEXAS O&G	133823	0.008	AMERADA HESS	109500	0.006
MARATHON	132977	0.008	CHAMPLIN	108770	0.006
CONSOL. NG	122000	0.007	COASTAL	100971	0.006
AMERADA HESS	109500	0.006	PANHANDLE EAS	97552	0.006
TOP 4	3119000	0.178		3954000	0.226
TOP 8	5143000	0.294		6133000	0.350
TOP 16	7548268	0.431		7937068	0.453
TOP 20	8046568	0.460		8353861	0.477
TOTAL U.S.	17506000			17506000	
	3555660	0.203		4507560	0.257
	5863020	0.335		6991620	0.399
	8605026	0.492		9048258	0.517
	9173088	0.524		9523402	0.544

Source: Oil & Gas Journal, October 17, 1983.

TABLE V

GULF COAST REFINERIES

Texas	Cap. (b/cd	Percent	Louisiana	Cap. (b/cd	Percentage
Exxon	427000	0.125	Exxon	419000	0.205
Amoco	415000	0.121	Cities Ser	297000	0.145
Shell	285000	0.083	Marathon	255000	0.125
Mobil	277000	0.081	Shell	218000	0.107
Gulf	268400	0.079	Gulf	199100	0.098
Texaco	242000	0.071	Conoco	156500	0.077
Arco	232000	0.068	Texaco	140000	0.069
Phillip	175000	0.051	Tenneco	114000	0.056
Union	120000	0.035			
Maratho	49000	0.014			
Conoco	33274	0.010			
Sub-tot	2523674	0.738		1798600	0.881
Top 4	1404000	0.411		1189000	0.582
Top 8	2321400	0.679		1798600	0.881
TOTAL	3417724	1.000		2041900	1.000

Ississ	Capacity	Percentage	Alabama	Capacity	Percentage
Socal	280000	1.000		131600	1.000

GULF COAST - PRE-MERGER			GULF COAST - POST-MERGER		
Exxon	846000	0.144	Exxon	846000	0.144
Shell	503000	0.086	Socal/Gulf	747500	0.127
Gulf	467500	0.080	Shell	503000	0.086
Amoco	415000	0.071	Amoco	415000	0.071
Texaco	382000	0.065	Texaco	382000	0.065
Marathon	304000	0.052	Marathon	304000	0.052
Socal	280000	0.048	Mobil	277000	0.047
Mobil	277000	0.047	Arco	232000	0.040
Arco	232000	0.040			
Conoco	189774	0.032			
Phillips	175000	0.030			
Union	120000	0.020			
Sub-Total	4191274	0.714			
Total	5871224	1.000			
Top 4	2231500	0.380	Top 4	2511500	0.428
Top 8	3474500	0.592	Top 8	3706500	0.631

Source: Department of Energy.

TABLE VI
EAST COAST REFINERIES

STATE	COMPANY	CAP. b/cd	PERCENT
Delaware	Getty	140000	0.111
Georgia	Amoco	24000	0.019
Maryland	Socal	14200	0.011
New Jersey	Exxon	100000	0.079
	Mobil	99700	0.079
	Texaco	90000	0.071
	Socal	80000	0.064
Pennsylvania	Gulf	174100	0.138
	BP Oil	168000	0.133
	Sun	155000	0.123
	Arco	125000	0.099
Sub-Total		1170000	0.929
TOTAL		1258950	1.000

EAST COAST REFINING AREA

PRE-MERGER			POST-MERGER		
Gulf	174100	0.133	Socal/Gulf	268300	0.213
BP	168000	0.133	Texaco/Getty	230000	0.183
Sun	155000	0.123	BP	168000	0.133
Getty	140000	0.111	Sun	155000	0.123
Arco	125000	0.099	Arco	125000	0.099
Exxon	100000	0.079	Exxon	100000	0.079
Mobil	99700	0.079	Mobil	99700	0.079
Socal	94200	0.075	Amoco	24000	0.019
Texaco	90000	0.071			
Amoco	24000	0.019			
Top 4	637100	0.506		821300	0.652
Top 8	1056000	0.839		1170000	0.929

Source: Department of Energy.

TABLE VII
WEST COAST REFINERIES

STATE	COMPANY	CAP. b/c	PERCENT
California	Socal	710000	0.306
	Union	197500	0.085
	Shell	184400	0.079
	Arco	178000	0.077
	Mobil	123500	0.053
	Exxon	106000	0.046
	Texaco	60000	0.026
	Gulf	51500	0.022
	Getty	38000	0.016
	Sub-Total	1648900	0.711
	TOTAL	2319990	1.000
Oregon	Socal	15000	1.000
Washington	Arco	126000	0.312
	Shell	91000	0.225
	Texaco	78000	0.193
	Mobil	71500	0.177
	Socal	5500	0.014
	Sub-Total	372000	0.920
	TOTAL	404470	1.000

PRE-MERGER			POST-MERGER		
Socal	730500	0.268	Socal/Gulf	782000	0.287
Arco	304000	0.112	Arco	304000	0.112
Shell	275400	0.101	Shell	275400	0.101
Union	197500	0.072	Union	197500	0.072
Mobil	195000	0.072	Mobil	195000	0.072
Texaco	138000	0.051	Texaco/Getty	176000	0.065
Exxon	106000	0.039	Exxon	106000	0.039
Gulf	51500	0.019			
Getty	38000	0.014			
Sub-Total	2035900	0.747			
TOTAL	2724460	1.000	Top 4	.572	
Top 4	1507400	0.553	Top 7	.733	
Top 8	1997900	0.733			

Source: Department of Energy.

TABLE VIII
MAJOR CRUDE OIL AND PETROLEUM PRODUCT PIPELINES

PRODUCT PIPELINES

Gulf Coast to East Coast (PADD III to PADD I)

Colonial	(2303 MBD Cap.)	Plantation	(825 MBD Cap.)
Gulf	16.80	Exxon	48.80
Texaco	14.30	Socal	27.10
Amoco	14.30	Shell	24.00
Cities	14.00		
Mobil	11.50		
BP Oil	9.00		
Conoco	7.50		
Phillips	7.10		
Union	4.00		
Arco	1.60		

CRUDE PIPELINES

Trans-Alaska	(1500 MBD Cap.)	From Gulf Coast to Midwest Capline	(1200 MBD Cap.)
BP/Sohio	49.18	Ashland	21.93
Arco	21.00	Marathon	15.69
Exxon	20.00	Texaco	15.09
Mobil	5.00	Shell	12.07
Phillips	1.66	Union	9.76
Union	1.66	Clark	9.76
Amerada Hess	1.50	Amoco	8.05
		BP/Sohio	5.10
		Sun	2.55

Source: "United States Petroleum Pipelines,
An Empirical Analysis of Pipeline Sizing,"
Department of Energy, December 1980.

EAST COAST REFINERY WHOLESALE GASOLINE PRICES
CENTS PER GALLON

T	MONTH	MAJ. REF PRICE	MAJ. REF. VOLUME	OTH.REF PRICE	OTH. REF. VOLUME	DIFF. PRICE	MAJ VOL PERCENT
J	11/83	88.8	290062	84.6	13028	-4.2	0.957
	10/83	90.1	279504	87.3	11941	-2.8	0.959
	9/83	90.6	289814	84.2	15247	-6.4	0.950
	8/83	91.6	304786	88.9	11059	-2.7	0.965
	7/83	91.3	329217	88.8	25750	-2.5	0.927
	6/83	90.4	368817	86.8	16522	-3.6	0.957
	5/83	89.4	321027		18228		0.946
	4/83	87.9	321770	82.7	42779	-5.2	0.883
	3/83	84.7	308108	79.9	36804	-4.8	0.893
	2/83	87.9	240797				
	1/83	91.4					
A	11/83	86.0	144784	83.4	41725	-2.6	0.776
		88.4	140639	85.4	41758	-0.3	0.771
		91.0	138447	88.2	39689	-2.8	0.777
		91.7	154089	89.1	38708	-2.6	0.799
		92.4	150848	89.8	35646	-2.6	0.809
		92.0	158359	90.1	33177	-1.9	0.827
		92.0	154439	89.9	41455	-2.1	0.788
		89.2	156251	87.5	36345	-1.7	0.811
		85.7	165408	83.2	35764	-2.5	0.822
		87.0	120487	84.3	44358	-2.7	0.731
		88.7	115454	85.4	50597	-3.3	0.695
	11/83	86.3	81364	82.2	51309	-4.1	0.613
L		89.1	78020	84.4	53472	-4.7	0.593
		91.0	79561	87.3	47671	-3.7	0.625
		91.6	90066	88.5	45987	-3.1	0.662
		92.3	84762	89.4	44166	-2.9	0.657
		91.8	86832	89.3	46209	-2.5	0.653
		91.6	82727	89.2	46950	-2.4	0.638
		88.9	80236	85.3	50563	-3.6	0.613
		85.5	87779	82.4	47622	-3.1	0.648
		87.4	64905	83.8	43621	-3.6	0.598
		88.6	74330	85.0	57762	-3.6	0.563
N	11/83	86.1	45427	82.7	78585	-3.4	0.366
		88.8	39293	85.7	53681	-3.1	0.423
		91.1	42790	87.6	70481	-3.5	0.378
		92.7	43846	88.9	82695	-3.8	0.346
		93.3	43442	89.6	80846	-3.7	0.350
	6/83	92.6	45343	90.3	100850	-2.3	0.310
		92.3	46288	88.5	90497	-3.8	0.338
		88.1	49772	85.6	83134	-2.5	0.374
		81.9	62138	80.2	103726	-1.7	0.375
		84.9	31250	82.5	74384	-2.4	0.296
		85.2	53343	84.4	80652	-0.8	0.398

Source: "Petroleum Marketing Monthly," DOE."

STATEMENT OF DAVID C. BATTEN, MANAGING DIRECTOR, FIRST BOSTON CORP.

Mr. Batten. Thank you for accommodating my schedule. I am the managing director of the First Boston Corp. in charge of the firm's capital markets department. And I would like to make some comments concerning the impact of the recent oil mergers on the financial markets.

There have been two issues raised relative to these transactions with which I disagree. The first is that these mergers, with apologies to Mr. Rothschild, have increased interest rates by adding to the demand for short term credit, and the second is that the refinancing of the bank debt incurred in these mergers will put substantial pressure on the capital markets. I do not believe either fear is warranted and would argue that these mergers have no meaningful impact on the marketplace.

Most simplistically, as a result of these financial transactions, shareholders receive cash in exchange for their shares—cash which any prudent person will immediately reinvest either in other stocks, in bonds or in short term instruments. To the extent that money does not end up under mattresses, there is relative equilibrium between the funds that the oil companies borrow from the banks and that which they pay to the shareholders. It is worth pointing out that by April 15, 1985, the IRS will probably collect several billions of dollars in incremental tax revenues from the gains shareholders realize from these mergers, taxes which will lower the amount of the deficit which will be required to finance.

As a result of what I would call a recycling of money, there should be no substantial net leakage from the overall markets to cause major dislocations and any timing or investment mismatch at the margin will soon disappear in a U.S. financial system in which domestic bank certificates of deposit are approaching $150 billion and the commercial paper outstanding is $200 billion and in an economy in which the Fed estimates net new credit extended in 1984 will exceed $450 billion.

It is also worth noting that the increase in short term credit demands and interest rates currently receiving so much press actually started in mid-1983, long before this merger activity, and that such economists as First Boston's Albert Wojnilower have been bearish on short- and long-term interest rates since the third quarter of last year.

The second assertion, namely, that related to the refinancing of the bank debt, is also a nonissue, in my opinion. In 1983, the U.S. Treasury raised over $235 billion in sales of securities with maturities of 1 year or longer. New issuance of debt and equity in the U.S. marketplace by nongovernmental issuers approached $120 billion. U.S. corporations also raised an additonal $7.5 billion overseas.

So the total new issue volume of taxable dollar dominated securities last year approached $450 billion. In the current environment, we believe that any of the major oil companies involved in these mergers, if they proceeded with a well-orchestrated strategy, could raise over $15 billion in U.S. and Euro capital markets over the course of the next 12 months without disrupting those markets or paying a meaningful premium. While this number sounds aggressive, I point out that the World Bank has averaged over $10 billion of new financing a year for each of the last 3 years.

Another example of how deep the current capital markets are, 3 weeks ago Texaco sold $1 billion of Euro-convertible bonds to offshore investors in just 5 business days. This transaction was 2½ times bigger than the previous largest convertible ever sold prior to that time and during the marketing period Texaco's common stock price actually rose by one-eighth of a point, even though the broad market was lower.

The large oil companies involved in these mergers could execute properly structured transactions of this size in either the U.S. or the Euro-dollar markets in either straight debt, convertible debt, common stock or floating rate debt.

The capital market participants today, in fact, are extremely interested in having the opportunity to purchase size in new issue high grade industrial securities. If there is any imbalance, investor demand exceeds the available supply, In 1983, only 11 percent of new corporate public debt was issued by strong industrial credits and currently the yield premium a large oil company would have to pay over U.S. Treasury's is the lowest it has been in years, in spite of the fact that investors realize the sizable refinancings oil companies will engage in over the coming months.

In summary, these mergers sound large, even huge by historical standards. They are, however, swaps of financial assets. They do not represent net new credit demands on the system. For the investor, the stock of an oil company is exchanged for cash which he in turn reinvests. For the corporate acquirer, the cash that is paid for stock is initially borrowed from a bank and then refinance in the capital markets.

Five, ten, even fifteen billion dollars is not loose change, but in a financial system in which the major trading houses such as those who will talk today now measure their annual trading volume in the trillions of dollars, a billion dollars is not as big as it used to be. The markets can handle these transactions in stride.

[The prepared statement of Mr. Batten follows:]

David C. Batten
Managing Director
The First Boston Corporation

Testimony before

The Sub Committee
on Energy and Mineral Resources

Tuesday, April 10, 1984

My name is David C. Batten. I am a Managing Director of the First Boston Corporation in charge of the firm's Capital Markets Department. I am pleased to have this opportunity to make some comments concerning the impact of the recent oil company mergers on the financial markets.

There have been two issues raised relative to these transactions with which I disagree. The first is that these mergers have increased interest rates by adding to the demand for short term credit, and the second is that the refinancing of the bank debt incurred in these mergers will put substantial pressure on the capital markets. I do not believe either fear is warranted and would argue that these mergers have no meaningful impact on the marketplace.

As a result of these financial transactions, shareholders receive cash in exchange for their shares--cash which any prudent person will immediately reinvest either in other stocks, in bonds or in short term instruments. To the extent that money does not end up under mattresses, there is relative equilibrium between the funds that the oil companies borrow from the banks and that which they pay to the shareholders. (It is worth pointing out that by April 15th, 1985, the IRS will probably collect several billions of dollars in incremental tax revenues from the gains shareholders realize from these mergers, cutting by that amount the size of the budget deficit to be financed.)

As a result of what I would call a recycling of money, there should be no substantial net leakage from the overall markets to cause major dislocations, and any timing or investment mismatch at the margin will soon disappear in a U.S. financial system in which commercial paper outstanding is $200 billion and domestic bank certificates of deposit are approaching $150 billion, and in an economy in which the Fed estimates net new credit extended in 1984 will exceed $450 billion.

It is also worth noting that the increase in short term credit demands and interest rates currently receiving so much press actually started in mid-1983, long before this merger activity (Exhibit I) and that such economists as First Boston's Albert Wojnilower have been bearish on short and long term interest rates since a similar time last year.

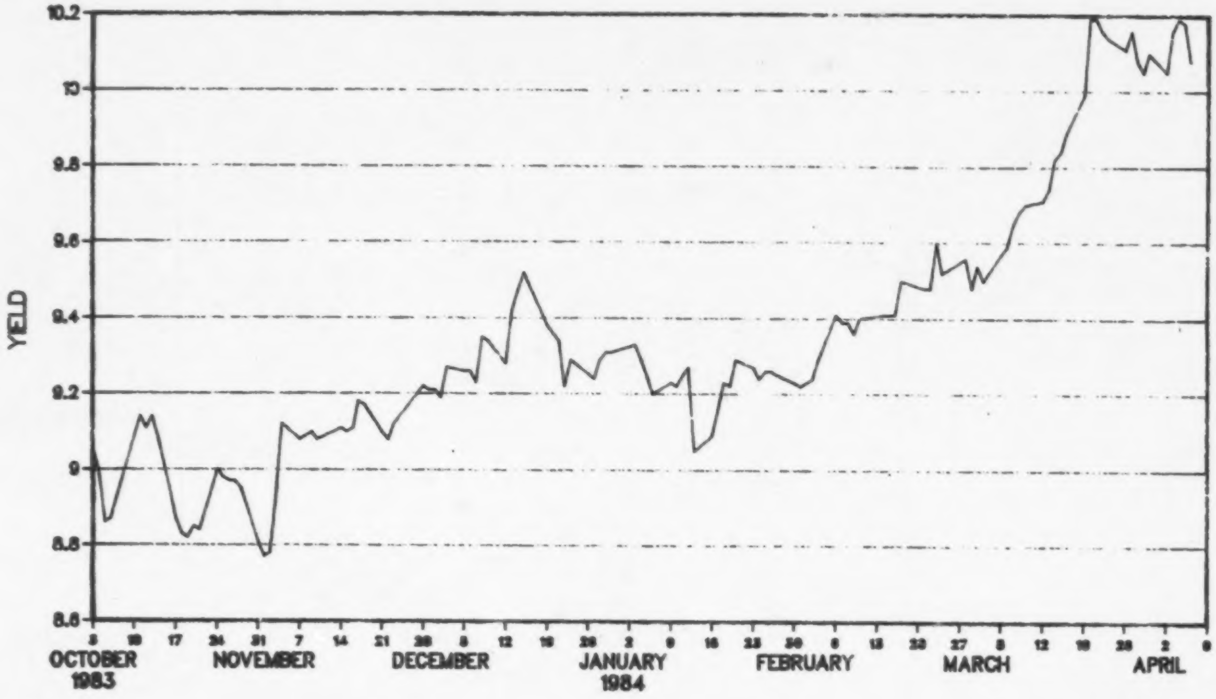
The second assertion, that related to the refinancing of the bank debt, is also a non-issue. In 1983, the U.S. Treasury raised over $235 billion in sales of securities with maturities of over one year, and new issuance of debt and equity in the U. S. markets by non-governmental issuers approached $120 billion (Exhibit II). U. S. Corporations also raised an additional $7 1/2 billion overseas. In the current environment, First Boston believes that any of the major oil companies involved in these mergers, if they proceeded with a well-orchestrated strategy, could raise over $15 billion in the U. S. and Euro capital markets over the course of the next twelve months without disrupting those markets or paying a meanful premium (Exhibit III). This number may sound aggressive, but the World Bank, as an example, has averaged over $10 billion of new financing a year for each of the last three years.

As an example of how deep the current capital markets are, 3 weeks ago, Texaco sold $1 billion of Euro-convertible bonds to off-shore investors in just 5 business days. This transaction was 2 1/2 times bigger than the previous largest convertible ever sold, and during the marketing period, Texaco's common stock price rose 1/8 of a point even though the Dow Jones Industrial Average fell 12 points (Exhibit IV and V). The large oil companies involved in these mergers could all execute properly structured transactions of this size in the U.S or Euro-dollar markets in straight debt, convertible debt, common stock and floating rate debt.

The capital markets today are extremely interested in having the opportunity to purchase size in new issue high grade industrial securities, and, if there is any imbalance, investor demand exceeds the available supply. In 1983, only 11% of new corporate public debt was issued by strong industrial credits, and currently the yield premium a large oil company would have to pay over U.S. Treasuries is the lowest it has been in years--in spite of the fact that investors realize the sizable refinancings oil companies will engage in over the coming months (Exhibit VI).

In summary, these mergers sound large, even huge by historical measures. They are, however, swaps of financial assets; they do not represent net new credit demands on the system. For the investor, the stock of an oil company is exchanged for cash which he, in turn, reinvests. For the corporate acquirer, the cash paid for stock is initially borrowed from a bank and then refinanced in the capital markets. Five, ten or 15 billion dollars isn't loose change, but in a financial system in which the major trading houses such as those represented here today now measure their annual trading volume in trillions, a billion dollars isn't as big as it used to be. The markets can handle these transactions in stride.

3—MONTH TREASURY BILL YIELD ANALYSIS



YIELD 3 MO T—BILL

THE FIRST BOSTON CORPORATION
FIXED INCOME RESEARCH

NEW ISSUE VOLUME ANALYSIS
($ in billions)

	1978		1983	
	$	%	$	%
U. S. Treasury	74.2	49.0	235.7	53.4
Mortgage Related	22.9	15.1	80.0	18.1
Corporate Debt & Equity (U. S. Market)	52.9	34.9	118.5	26.8
U. S. Corporate (Euro-market)	1.5	1.0	7.5	1.7
TOTAL	151.5	100.0	441.7	100.0

III.

MAJOR AA OIL COMPANY

Financing Capacity(1)

		Potential Size (in billions)		Maturities
SHORT TERM MARKET				
	Commercial Paper	$4.00-5.00		Up to 270 days
	Master Notes	$1.00-1.50		Up to 1 year
	Subtotal Short Term		$5.00-6.50(2)	
LONG TERM MARKET				
U.S.	Public Debt	$3.00-4.50		1-10 years
		0.50-1.00		20-30 years
		$3.50-5.50		
	Private Debt	$0.50-1.00		1-10 years
	Equity-Straight	$1.15(3)		Not Applicable
	Convertibles	0.50-1.00		Up to 25 years
		$1.65-2.15		
	Subtotal U.S.	$5.65-8.65		
Europe	Public Debt	$2.75-4.00		3-15 years
	Convertibles	.75		7-15 years
	Other Currencies	$1.00		10-12 years
	Subtotal Europe	$4.50-5.75		
	Subtotal Long Term		$10.15-14.40	
	TOTAL CAPACITY		$15.15-20.90	

---

(1) Market access timing: 1-2 months for short term market, 6 months for U.S. private market, 12 months for all else.

(2) Could swap up to $3 billion into maturities ranging from 2 to 10 years

(3) Common - $.75 billion; preferred - $.40 billion

IV.

Price Movement of Texaco Inc. Common Stock And Dow Jones Industrial Average During $1 Billion Convertible Issue

	Texaco		Dow Jones Industrial
Date	Close	Volume (000 Shares)	Average Close
3/14/84	$39.000	373,500	1166.030
3/15/84 (launch)	38.750	481,100	1167.390
3/16/84	38.625	279,800	1184.350
3/19/84	38.375	530,000	1171.370
3/20/84	38.500	553,000	1175.770
3/21/84	39.125	394,300	1170.850
3/22/84 (price)	38.875	386,100	1155.880
3/23/84	38.875	194,200	1154.830
3/26/84	39.000	159,000	1152.940
3/27/84	39.000	278,100	1154.310
3/28/84	39.000	428,400	1174.620

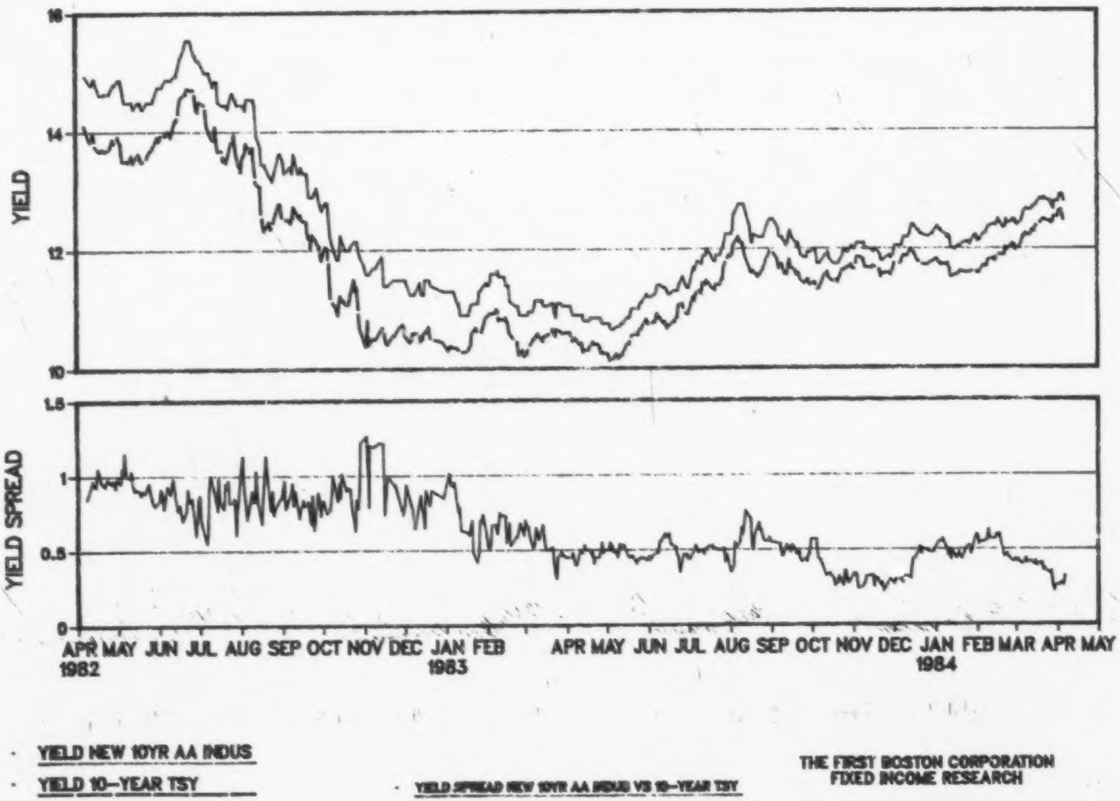
V.

Closing Price Of Selected Oil Company Stocks

Date	Texaco	Exxon	Mobil	SoCal	Arco
3/14/84	$39.000	$38.250	$29.875	$34.000	$42.250
3/15/84 (launch)	38.750	38.750	29.750	34.500	45.750
3/16/84	38.625	39.000	30.125	34.500	45.875
3/19/84	38.375	38.625	29.750	33.875	46.000
3/20/84	38.500	38.375	30.000	34.375	46.250
3/21/84	39.125	37.875	30.875	34.375	45.750
3/22/84 (pricing)	38.875	37.625	30.250	33.750	46.000
3/23/84	38.875	38.000	30.125	33.875	46.500
3/26/84	39.000	38.375	30.000	34.500	46.125
3/27/84	39.000	38.750	30.250	35.000	46.625
3/28/84	39.000	39.000	30.125	35.875	47.500

VI.

10—YEAR AA INDUSTRIAL YIELD SPREAD ANALYSIS



THE FIRST BOSTON CORPORATION
FIXED INCOME RESEARCH

Mr. **Sindelar**. Thank you, gentlemen, for your testimony. Your statements will be submitted in their entirety.

Pursuant to the directions of the chairman, the subcommittee is recessed until 2:30 p.m. this afternoon.

[Whereupon, at 1 p.m., the subcommittee was in recess, to reconvene at 2:30 p.m.]

AFTERNOON SESSION

Senator **Warner**. This hearing will resume. The chairman apologizes. He is trying to do too much in one day. We will now give an adequate opportunity for everyone to be heard on the other aspects of this issue.

We have panel seven, Dr. Mark Cooper; Larry Napoleon Cooper; and Michael S. Kirschner.

STATEMENT OF DR. MARK N. COOPER, DIRECTOR OF ENERGY, CONSUMER FEDERATION OF AMERICA

Dr. **Cooper**. Thank you, Mr. Chairman. I have submitted a lengthy written testimony and I will only briefly summarize it. You are going to hear a few different opinions than you did this morning.

Senator **Warner**. That is all right.

Dr. **Cooper**. Simply put, the 35 million members of the Consumer Federation of America, which represents 35 million members in various consumer, low income, farm, public power, cooperatives, senior citizen groups, are deeply concerned about the current wave of mega-mergers.

We believe that they can do little good for the public and a great deal of harm and if we cannot stop the ones that are pending, at least we should stop the tidal wave here and now. I will outline five lessons that can be learned from the recent mergers and I think five areas where Congress should think long and hard about changing national policy. Above all, I think that we need to get away from ungrounded theories and the mythology of these mergers.

The second piece of that mythology is of course the question of efficiency and we heard about that all morning. In fact notwithstanding the assertion that because businessmen concede these things they must be right, they were not in fact designed in the interest of efficiency. In fact, the businessmen who conceived them did so under extreme duress.

The motivation to sell was a family squabble between the super rich in two cases and the threat of a hostile takeover by a group of stockholders driven by a tax scheme in the third. I think we got a hint of some of those differences of opinion this morning when we heard one oil company representative say the stockholders are smart and another one say, no, they were stupid to accept this deal. In point of fact, it is not efficiency that is driving them. The intentions were different. Similarly, we always get in these mergers for cross-purposes of senior management, that is the golden parachutes that let senior managers down so gently. We heard some complaints by some oil industry representatives about the management problems and the benefits that senior management get from these mergers.

Simply put, private gain can conflict with the good and these motives must be explored, regulated and closely and sharply curtailed and the FTC has suggested that they are going to look at some of that.

Now, on the buying side, the motivation was as much tax advantages rather than perfect economics. Transferring resources in the ground enables the acquiring company to write up the value of the assets and pay less tax than the original owner. It is the tax break that is being sold as much as the oil.

Transferring resources from an unintegrated company to an integrated one or from a company that is more than selfsufficient to one that is less takes oil off the open market, subjects it to transfer pricing and reduces windfall profit taxes. It is the tax advantage that is being sold as much as the oil. Using foreign loans which are collatarized with unrepatriated profits gives companies the full use of untaxed dollars.

Again, it is the tax advantage that is being sold as much as the oil.

Lesson two, change the tax treatment of mergers to make them less inviting than they currently are. The industry representatives we heard this morning and analysts insist that the mergers are part of a necessary restructuring of the industry. But there is absolutely no reason that the industry must shrink by doubling the size of its largest units. There is no evidence that the economies of scale are gained by increasing the size of firms such as Texaco, Socal, and Mobil.

There is no evidence that exploration activities will be increased as a result of these mergers and, in fact, many industry analysts have recognized that such activities will be decreased. Of course, we must never expect an industry executive testifying on the Hill to say "My merger is too big, or socially counterproductive."

We frequently hear in the courts that maybe the next one should be stopped, but mine is a righteous merger, a merger in the interest of efficiency and the social good. Of course, with that sort of free enterprise system, they would free enterprise us into one massive company and testify that such a company would be more efficient because it could integrate and coordinate all decisions and resources.

The fact that there would be no competitors out there for that company, no competitors to impose discipline, is of no concern to them. That view neglects the critical role that competition plays in forcing economic actions to be efficient and in restraining them from increasing profits by raising prices rather than lowering cost.

Free enterprise motivates people, and we hear an awful lot about that, but competition disciplines them. It is the combination of the two that is the genius of our economic system. Obviously, we do not have only one company; we have a number of very large ones and a number of small ones.

The public policy question is, When does the reduction in the number of companies impose a cost onto society by reducing the rigors of competition, the discipline of competition? The answer is complex and it is not to be found in a mechanistic application of simple formulas. It requires a careful analysis of the quality of specific industries and markets.

The oil industry has been and continues to be typified by a number of characteristics that make it particularly vulnerable to the negative, social, and economic effects of reductions in competition. The industry is typified by lower elasticities of supply and demand and high income elasticities. To turn that into simple English, we need a lot of it. We have trouble finding substitutes for it and we have trouble getting production to respond to price increases.

It is typified by high barriers to entry and a very noncompetitive history. Concentration ratios are particularly misleading in the industry because of joint ventures, foreign partnerships, interlocking directorates, exchange agreements, vertical integration within the industry and a horizontal integration into other sources of energy.

Under these circumstances even small changes in market shares with the array of market actors can have very large effects on market behavior. In my testimony, I have provided a formal analysis which starts from the famous Herfindahl index, but then adds these critical considerations, such as the rivalry between firms, the size of the competitive fringe, and the elasticity of supply and demand.

I have applied those to the Getty/Texaco merger and find that even at the level of crude, there are hundreds of millions and perhaps billions of dollars at stake in potential price abuse, the use of market power in consumers' pockets. When downstream impacts in the middle term are considered, these consumer prices and the loss in the impact from these mergers would be much larger.

Lesson three, qualitative considerations and the unique characteristic of the oil industry must be taken into account in public policy.

I also believe that there is a waste of resources in planning and executing these mergers. I believe there are strains on financial markets. It is fascinating to hear people define sort of the flexibility of the financial market as always $5 billion bigger than the last merger. In point of fact, when you attempt to recycle money, people are taking profit on it. It has to be harder to find. It does not disappear. No one says it disappears. But it has to be harder to grab ahold and slow down.

I think the mergers also create problems in the world oil market. On the one hand a great deal of oil has been acquired by companies that are partners in ARAMCO. Historically they have been among the least aggressive of the international majors, placing access to Saudi crude above other concerns. The removal of that cil from the market can only weaken market forces worldwide.

The point was raised this morning that since these are people who are tied into ARAMCO, does not the acquisition of this oil make them less amenable to the Saudis? A point of fact the companies that had the oil had nothing to do with the Saudis. They were among the most aggressive, certainly in the Getty case, competitors in the market. Well, that oil has now been removed.

In one sense you are replacing a loose cannon with a muffled one. On the other hand the forced sale of assets that the Federal Trade Commission will undoubtedly insist upon will give members of OPEC an opportunity to diversify into downstream operations. This too will weaken market forces.

Lesson five, the world market and the U.S. role in it must be considered. The conclusions that policymakers should draw from these lessons is simple. We need not fear to oppose mergers on social, economic, and energy policy grounds. And those considerations can override the belief in free market forces. We can, in fact, temper free market forces when there are social and economic impacts.

In this regard, the opposition to mergers has been completely misrepresented. First, the antimerger position does not see the prevention of mergers as a solution to the energy problem. We keep being accused of that. Nothing could be farther from the truth. We are simply trying to prevent the problem from getting worse.

Second, the antimerger position is portrayed as being concerned only with domestic U.S. sources of supply. Nothing could be farther from the truth. All intelligent analysts have long recognized that U.S. prospects are declining and they have focused their attention on worldwide prospects. But we need to make two points about this question of prospects.

First, we are pointing out that when oil was allowed to go from $10 a barrel to $30 a barrel in the United States that was the quid pro quo. Industry and Government alike said we need to drill more holes to get more oil. Now, we are told that there is no sense in drilling holes, because the prospects are not bright. Some of us feared that was going to be the outcome from the beginning.

Of course, this morning you heard a disagreement. Some people said there were incentives. Some people said we have plenty of money but we do not have the prospects. In point of fact, the quid pro quo has more holes, more drilling in exchange for decontrol.

We have had decontrol and we have had the runup in prices and suddenly now we are running out of prospects. More importantly, if the problem is that private sector companies cannot tolerate risks in this country or do not have the political clout to conduct enough non-U.S., non-OPEC exploration, we need to confront that problem directly.

Merged companies are not necessarily the solution to confronting that problem. I believe they will be less suited to taking aggressive positions. They will certainly be more risk adverse, because they have more debt. I also believe that they will have less incentive because they are more self-sufficient in crude.

Finally, I think we need to address the anomaly of the oil companies having a lot of cash from existing production, but few ways to use it in exploration in the oil industry. In economic language, that excess cash results from a combination of oligopoly profits and economic rents, that shareholders and management are concerned about those profits and rents is no surprise. Truly, competitve markets tend to drive out such profits and equitable societies tend to tax away such rent.

The effort to dissipate and redevise those rents and profits to make them less embarassingly obvious can and should be regulated much more closely in the interest, I believe, of both economic efficiency and social justice.

Thank you.

[The prepared statement of Dr. Cooper follows:]

TESTIMONY OF

DR. MARK N. COOPER

DIRECTOR OF ENERGY

CONSUMER FEDERATION OF AMERICA

before the

SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES

of the

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

on

LEGISLATION AFFECTING OIL COMPANY MERGERS

April 10, 1984

Mr. Chairman and Members of the Committee,

My name is Dr. Mark N. Cooper, I am Energy Director of the Consumer Federation of America (CFA). CFA is composed of 200 consumer, senior citizen, low-income, union, farm, public power, and cooperative organizations representing more than 35 million people.

I appreciate the opportunity to testify before you today on legislative proposals governing corporate mergers and takeovers. Legislative action is urgently needed because the antitrust activities of the executive branch have broken down. The public interest has been neglected by an administration that early and loudly declared open season for corporate mergers.1/

Encouraged by this permissive attitude, the oil industry has engaged in a frenzy of merger activity. This activity is neither motivated by, nor will it result in greater economic efficiency. Rather, it has been caused by two factors. First, the companies are flush with cash and assets as a result of being able to sell oil that costs less than five dollars per barrel for more than twenty five. Second, there are huge tax advantages to transferring the ownership of oil in the ground, to concentrating it in integrated companies, and to leveraging those transfers with unrepatriated profits.

Yet, there is a broad range of expert opinion that is convinced that these mega-mergers will cost consumers dearly in both the short and long terms.2/ Within the oil industry, those costs will be measured in terms of hundreds of millions of barrels of decreased production and of billions of dollars of increased costs to consumers at the pump. Outside of the oil industry they will be measured in the distortion and suppression of economic activity as well as the squandering of resources.

In my testimony today I will outline the theoretical and empirical explanation of why this damage to the public interest results from mergers such as these. In so doing I will show why the current approaches to assessing the threat posed by specific mergers to the public interest is totally inadequate. I will begin by briefly mentioning the impacts of the mergers that fall outside of the oil industry and then move on to the focal point of my concerns, which is the distortion of the structure of the oil industry that results from these mega-mergers.

FINANCE AND CREDIT MARKETS

It would seem obvious that with ARCO and Socal tying up $25 billion in credit lines, money would be harder to find than if they were not holding those funds. That certainly would seem to be the logic applied by bankers and Wall Street representatives when they rant and rave about federal borrowing placing a squeeze on other borrowing. That would seem to be the likely impact when one considers the fact that those credit lines will be tied up for months and months and they are equal to the total sum of new credit normally created by nonfinancial corporations over such a period.

One reaches a similar conclusion when one considers the tax implications of these mergers. By writing up the value of the assets, oil company income taxes are reduced. By removing crude from open market transactions and subjecting them to the transfer pricing of integrated companies, windfall profits taxes will be reduced. No one denies that these tax advantages are a large part of the motivation for these mergers. They simply would prefer that congress not consider these revenue implications as it wrestles with federal deficits.

The massive expenditure of resources in contemplating and executing these mergers, be they used to initiate or defend against the takeover, are another cost imposed on society. Contrary to the argument of the oil company executives who insist that because they are businessmen they must be doing it right, these resources have been dissipated in a flood of successful and unsuccessful acquisitions that do not add one iota to the productive capacity of society. Indeed, it is widely acknowledged that several recent mergers were precipitated by family squabbles among the super rich. The fact that those resources were extracted from consumers through the massive price increases of the past decade makes the recent round of mergers even more troubling. If they had been left in the pockets of consumers, they certainly would have done more good.

Ultimately, however, the net effect of mergers on society will be determined by what they do to the oil industry. That is where their largest and most direct impact falls, and that is where we observe the failure of this administration to protect the public interest. As bad as the impact of these mergers on the general economy is, their impact on the industry will be far worse.

THE ABSURDITIES OF CURRENT ANTI-TRUST ENFORCEMENT

Last week, Senator Warren Rudman dramatically underscored the failure of the current approach to antitrust enforcement before the Senate Judiciary Committee. Based on national concentration ratios, he pointed out that the current guidelines would not trigger an automatic challenge to a merger between Exxon, Arco, Amoco, Chevron, Texaco, and Mobil. Such a massive corporation, created by merger, violates our fundamental notion of antitrust protection.

Thus, while Boone Pickens and others who stand to profit from the recent round of mega-mergers argue that the antitrust tests are rigid and rigorous, Senator Rudman's example demonstrates that they are ludicrously lenient. In fact, there is a series of discrete absurdities in the current approach to antitrust enforcement that constitutes a monstrous failure to protect the public interest.

First, those charged with protecting the public interest seem to have forgotten that oil is the key to the industry. Their response to merger after merger is to zero in on refining, transportation and marketing, while neglecting crude. They are concerned neither with concentrations of ownership of crude, nor with the fact that refineries are useless without access to crude. Although it is necessary to identify specific geographic markets with respect to refining, marketing, and transportation and ensure the viability of competition in those markets, it is also critical to recognize that control over crude yields at least as much market power as control over the other aspects of the industry.

Second, those charged with protecting the public interest have given up all consideration of the overall outcome of merger mania. Suppose Senator Rudman's mega-merger took place in five discrete bites instead of one huge gulp. Would the five smaller steps be less likely to be stopped than the one huge leap, even though the outcome is essentially the same? Unfortunately, the answer appears to be yes.

In each merger, the argument is made that this particular merger is not the one that threatens the public interest, although the next one might.3/ When the next one comes along, the argument is made that since it is no different from the last one, which did not pose a threat to the public interest, the current merger could not possibly pose such a threat either. We are nibbled to death, although mergers of $5 billion and more are rather large nibbles.

This reasoning is familiarly known as a Catch 22. The outcome of the merger process will be utterly disastrous for the public interest, but, because no discrete merger can be identified as the specific culprit and each merger must be treated "equitably," no one bears the responsibility for the ultimate outcome. The disaster cannot be prevented.

Third, those charged with protecting the public interest seem to have forgotten that they are supposed to be the line of first defense of the public interest, not the last resort. Their refusal to bring cases -- indeed, their frantic efforts to patch up markets in order to slip mergers through -- has robbed the people as a whole of effective legal representation.

Interestingly, if the potential merger is hostile, rather than friendly, it is much more likely to be stopped. In the case of Mobil/Marathon, a small merger compared to the recent giants, the administrative branch could not see the threat to the public interest that the court was easily able to see when the target of the hostile takeover made the case.4/ On substance, the Getty/Texaco merger was worse than Mobil/Marathon but the people could not get to court.5/

THE NATURE OF THE THREAT TO THE PUBLIC INTEREST

In order to understand the nature of the threat to the public interest that the recent wave of mega-mergers presents, I believe we must distinguish between the free enterprise system that oilmen like T. Boone Pickens, George Keller and J. R. Ewing like to talk about, and the competitive free market that is the truly dynamic economic structure in which we all believe. If J. R. had his way, he would "free enterprise" us into one huge oil company. He would insist that his one company is more efficient since it can integrate and coordinate all phases of the industry and aspects of decisionmaking.6/

Although it is basic economics, we should point out what J. R. would not be likely to tell us about his one company.7/ He would not tell us that there would be no one to restrain his price increases. Because oil is a vital commodity -- economists say it is price inelastic -- he would be able to push prices up dramatically and increase his profits. With no one around to steal his business, he would maximize his profits by increasing prices and cutting back output as much as he wanted.8/

J. R. would also not tell us that, with no competitors out there, he would not remain efficient for very long, if he ever was. After all, the pressure to cut costs would be reduced -- raising prices is invariably easier. Mistakes -- for example choosing to develop the wrong prospects -- would go unpunished since there are no competitors to threaten to steal his market with lower priced supplies.

The concentration of market power imposes at least these two costs on society -- an unjustified and inequitable increase in J.

R.'s profits and an inefficient exploitation of resources. In contrast, competition works to the benefit of society because it disciplines economic actors. It forces producers to be efficient and restrains their inclination to increase profits the easy way -- by increasing prices rather than cutting costs or producing more. Free enterprise motivates people and competition disciplines them. It is the combination of the two that is the genius of our economic system.

The essence of antitrust is the recognition that free enterprise, unrestrained by competition, turns from a beautiful engine of production into an ugly vehicle for exploitation. Those who maintain that any incursion on the freedom of enterprise reduces efficiency have simply failed to understand the balance between the freedom of action and the rigors of competition that is necessary to make the system work.

CONCENTRATION AND MARKET POWER IN THE OIL INDUSTRY

Of course, we do not have one company in the oil industry -- although we may get there at the rate we are going -- we have a number. The critical public policy question is, when does the reduction in the number of independent actors in a market begin to impose the social and economic costs identified above?9/ The answer is, it depends on the nature of the market. The weakness in recent antitrust enforcement in the oil industry is that it has blindly applied mechanistic formulas without applying sound judgement in light of the nature of the industry.

When does a merger hurt? The underlying issue in the analysis of the public interest in merger activity is market power. Market power is the ability to raise prices above costs, which is a distortion of the competitive market outcome.10/

It is important to get back to basics in defining market power in the petroleum industry because of the unique characteristics of that industry. Above all, it is important to recognize that market shares, on which so much attention has been focused of late, are only one aspect of that ability. A host of other factors also affect market power dramatically.

First, it is of critical importance to carefully identify the relevant geographic market.11/ Petroleum -- crude or product -- is difficult and expensive to transport and store. Transportation costs create distinct regional submarkets. Transportation costs become barriers to entry and the abuse of market power behind those barriers can impose severe costs on consumers.

When the price of crude and the cost of transportation were relatively equal, oil industry analysts had a strong sense of the importance of spatial/location economics.12/ Recently, as crude costs have mounted, their attention shifted, but that should not excuse careful consideration of this factor in antitrust analysis. Even at the level of transportation costs of crude supplies, potential price distortions of $2 to $4 per barrel within regionally defined markets are possible. These are not to be ignored.13/

In addition to defining the geographic scope of the relevant market, it is necessary to identify the other basic characteristics of the market.14/

1) The ability of consumers to reduce their demand in response to a price increase -- the elasticity of demand -- is a paramount concern. This reduction in demand for the product in question can come about either through simple reduction in consumption or product substitution.

2) The ability of suppliers to increase their output in response to the price increase and "steal" the market of the price increaser is an important factor as well. One aspect of that ability deals with the size of the potential competitors.

3) The ability of suppliers to increase capacity also raises concerns over the marginal cost of expanding supply. Although the concern is with the overall elasticity of supply, the behavior of the competitive fringe -- those firms that tend to compete aggressively at the edges of the industry -- is particularly important. The particular characteristics of the cost of expanding supply may set important constraints on the ability of firms to respond.

4) There is also a need to model oligopolies and to take into account the pattern of conduct by firms or interfirm rivalry. If the merger changes the response of the market to price increases, it can dramatically alter the market power of important actors in the market. If the historical pattern has been for the actors in the market to reinforce price increases, either cooperatively or noncooperatively, this factor is extremely important.

These concepts can be summarized in a simple formula (see Exhibit 1). The measure of market power is the ability to raise prices above marginal costs. The Lerner index modified to incorporate these qualitative factors captures the price distortions that result from reductions in competitive forces.

Thus, economic theory and simple common sense tell us that in a market where consumers and producers cannot respond easily to attempts to raise prices, small market shares may confer market power and create the potential for abusive pricing practices. Where a distinction can be made between an oligopolistic core and a competitive fringe, careful analysis of the impact of the merger on the fringe is particularly important. Similarly, where there is a general pattern, or history of market responses which sustain price increases, antitrust enforcers should be especially mindful of increases in market shares or other factors which might increase the potential for the abuse of market power.15/

THE TENDENCY OF THE OIL INDUSTRY TO NONCOMPETITIVE BEHAVIOR

The history of the anti-competitive nature of the oil industry has been well documented before the congress.16/ There is virtually no period in the past half century when noneconomic factors have not played a major role in restricting output and increasing prices. The origin and strength of these factors has varied from time to time and place to place, but they have never been totally absent and generally they have been quite strong.

There are certain classic conditions that typify the oil market which contribute to its tendency toward noncompetitive behavior. It is capital intensive and technologically advanced, conditions which create significant barriers to entry. Ownership is moderately concentrated both here and abroad. Joint ventures and other similar arrangements here and abroad reinforce that concentration. These basic ingredients of oligopolistic industries are reinforced by several other characteristics of the oil industry.

Oil has a unique combination of characteristics that stem from it vital role in advanced industrial society. These can be divided into demand and supply side characteristics.

Oil has a very low elasticity of demand and a very high income elasticity. In simple english, we need a lot of it to sustain our advanced standard of living and we have a great deal of difficulty finding substitutes for it.

On the supply side, oil has proven to be extremely difficult to stockpile. The sustained availability of oil has been virtually synonymous with the continuous flow from wellhead to burner tip. This has made oil an extremely inviting target of efforts to manipulate the market. It has given potential price abusers considerable leverage in achieving their goals. Small changes in the flow have large effects on the market.

Finally, the fact that the supply side is prone to creating large economic rents has given suppliers added incentive to restrict output.17/ That is, once oil is found, production costs are small. At any moment, additions to supply appear very expensive relative to production from existing reserves. Forcing prices up to the cost of additions to supply yields large rewards to those who possess existing reserves. Those with existing reserves have a strong incentive to bend over backwards to hold down their production and ensure that the market price is set by the expensive marginal supplies.

Exhibit 2 gives a graphic description of the factors that have led to the persistent noncompetitive conditions in the oil industry. Exhibit 3 shows a plot of the actual world price of crude oil in the post World War II period (in real 1972 dollars) compared to the marginal cost of producing oil, which would obtain in a competitive market.18/ The current marginal cost is set at $15/barrel in 1983 dollars, or about $7 per barrel in 1972 dollars.19/ It is a most generous estimate of the actual cost. This is three times as high as the marginal cost of $2.65 assumed for 1972.20/ Again, that is a generous estimate. Marginal costs are assumed to have been constant between 1946 and 1972, another generous estimate.

The pattern is exactly what we would expect from an oligopolistic industry.21/ The exercise of market power drives prices above their competitive path and the fact that entry is restricted, etc., sustains prices for long periods. Sharp price increases transfer huge resources to producers and then prices slowly erode back toward the competitive path as competition at the fringe takes place and the resource base is depleted. The oligopolistic nature of the industry makes the periods of excessive price long and the excesses large. Literally, out of every one dollar paid for oil at the wellhead since the World War II about fifty cents has been in excess of marginal costs. Moreover, the actual U. S. price was even higher than the world price between 1958 and 1973 due to the imposition of import quotas.22/

THE GETTY/TEXACO MERGER AS A MICROCOSM OF THE PROBLEMS THAT MERGERS PRESENT

This general analysis is directly applicable to the current spate of mergers. In the following discussion, using variants of the above arguments, I show that the test applied to the crude oil market in the Getty/Texaco merger were grossly inadequate.23/ It failed to deal realistically with the fundamental characteristics of the oil market. This failure, which one can only presume will be applied in other pending mergers, is the reason that I believe a moratorium, coupled with aggressive legislative action is called for. I then suggest the direction that analysis of the two pending mergers should take.

Before quantifying the impact of the Getty/ Texaco merger, I will describe in qualitative terms how it will affect the market. I begin with the unique characteristics of the West Coast market. Because the West Coast is a regionally isolated submarket of the world petroleum industry with a chronic surplus, there is a special potential for abuse of market power. The relative isolation of the West Coast from the world oil market makes local forces of supply and demand particularly important in determining prices in the market.24/ With an excess of supply available in the market and high transportation costs to other markets, there are pressures to dispose of crude and product within the region. This augments competition and lowers prices in the market. It also creates additional incentives and payoffs for those who successfully restrict output in the effort to raise prices.

The Texaco/Getty merger poses a particularly virile threat to the public interest because of the role and behavior of the parties in this particular market. The merger would dramatically lower the effective market share of the competitive fringe in the California market and the entire West Coast. Simultaneously, it would strengthen the position of a relatively weak integrated major and sharply reduce its incentives to behave in a competitive fashion.25/

The proposed merger unites two companies that are located at points that are economically and logistically critical to the supply of the region. Getty, historically one of the more vigorous independent companies, stands at the economic fringe as a high marginal cost supplier. It also plays a critical role in the competitive fringe as a supplier of crude and product to independents. It has very different assets and interests than the other large scale producers in the region. Texaco, which is also a high cost supplier, confronts the competition from the position of a weak international major oil company on the West Coast with critical needs for crude in that market. The merger would eliminate from this market an important point of competition and pressure to increase supplies.

Texaco, as an integrated major in a crude-short position on the West Coast, would have been forced, absent the merger, to continue to pursue crude to shore up its weakness. Getty, an important independent with a large part of its operations on the West Coast, would have been forced to do so as well. Each would have drawn from separate capital resources and each would been forced to pursue distinct sets of exploration, development and production projects to preserve its position. As a merged company Texaco/Getty will have neither the capital resources nor the economic incentives to pursue the same array of high cost supplies. As a result, exploration, development and oil supplies will be reduced in both the short and the long terms.

From the point of view of the interest of the consuming public and the public interest, a particularly damaging effect will be felt in the immediate future because the incentives of the merged company to reduce its investment and outlays will have near term impacts on supplies. The new actor will have a unique interest and capacity to reduce production in the region.

Alaska North slope producers, who account for 60 percent of the production on the West Coast, have significant incentives to keep production levels up because of large profits reaped from transportation. The rate of production from the Getty holdings, however, is much more sensitive to near term operating costs. Its level can be held down with decisions not to spend in the present and the underlying asset will not be affected. The spigots can literally be turned on and off in the near term with the injection or withdrawal of money.

Texaco, faced with significant exposure on the OCS in both Alaska and off California and with strained resources, will have a strong incentive to cut back on the rate of production from the Getty holdings. Price enhancement in the near term due to the reduction of output at the production end and the weakening of the independent sector at the marketing end will be reinforced by the reduction of the operating expenses. Texaco's asset horizon will be extended as well. Since this is a period of relatively soft oil markets, both the world market and the regional market, the asset can be expected to appreciate as a result of less intensive exploitation. Needless to say, this would be an added incentive for the company to hold down production.

Incentives to reduce production and surplus in the region and to weaken the independent sector reinforce one another. The weakening of the independent sector would come about in part because Getty marketing outlets, which had been operated in an independent fashion, will have passed to one of the largest, major, international integrated companies. More importantly, a company which had been willing to deal with other independents will have passed into the hands of an international major, which typically eschews such dealings. The result of these dynamic factors and the strong incentives that the merged company would have to pursue a price enhancing strategy would have a major impact on prices in the region.

THE GETTY/TEXACO MERGER: A QUANTITATIVE ANALYSIS

Returning to the more formal analysis presented earlier, I would argue that the Getty/Texaco merger affects each and every term in the equation measuring price distortion sharply and dramatically in a direction that will increase price distortions.

With respect to the numerator, nationally and on the West Coast, it increases the market share of a firm which is a member of the core set of international major oil companies. In so doing, it is likely to reduce the ability of the market to move in a direction opposite to that of the dominant firms. The chances that other firms will move to restrain price increases when the core tries to impose them will be reduced.

With respect to the denominator, it reduces the market share of the competitive fringe which is not very large in the industry. It also strikes at a fringe supplier that has a particularly large elasticity of supply on the West Coast because of the nature of its holdings.

An empirical analysis of the characteristics of the two companies demonstrates that each of these effects is quite significant. The assumptions of that analysis are as follows. On the basis of average product consumption, I estimate the magnitude of market elasticity of demand to be -.64.26/ The supply elasticity is set at .4.27/ Market shares on the West Coast are readily available.28/

Applying the complex approaches to modeling the impact of mergers on price distortions and factoring in total market structures yields striking results (see Exhibit 4).

The Herfindahl index, which yields notoriously low estimates of impacts, suggests an increase in price distortion of .22 percent. The dollar impact would be about $44 million per year on the West Coast. That is, a price increase of .22 percent resulting from market distortions at the level of crude would translate into $44 million in increased consumer costs.

The two additional characteristics of the market are then modeled separately and in tandem. Assuming no competitive fringe and a change in market structure from neutral to slightly reinforcing (K=0 to K=.1) yields an increase in price distortion of 2.7 percent. The dollar cost to consumers would be over $.5 billion. Assuming an impact on market behavior twice as large would almost double the distortion and dollar impact.

The removal of Getty from the fringe also increases the impact compared to the simple Herfindahl approach. Price distortions are increase between two-thirds of a percent and slightly more than one percent depending on the assumption made about the size of the competitive fringe.

Combining the effects of a reduction in the competitive fringe and an alteration in the directional response of the market yields estimates of the increase in market distortion between approximately 3 percent and 6 percent. The dollar impact would be between $.5 and $1.2 billion.

In light of this analysis, it is clear that the merger poses a major threat to the public interest. The impact is certain to be well over $100 million and could be several times that large. The mechanistic application of market shares analysis seriously underestimates the magnitude of the impact of the merger because it takes neither the basic characteristics of oil nor the unique characteristics of the regional market into account.

This analysis of the West Coast crude oil impacts of the Getty/Texaco merger should not be taken to imply that the effects of the merger on other regions or in other aspects of the industry should not be considered. It is intended to stress the fact that crude and regional factors are critical as downstream activities.

Unfortunately, the FTC chose a quick fix to the crude oil problem on the West Coast (as Commissioner Pertschuk pointed out, a pseudo regulatory approach) rather than a court challenge. It is doubtworthy that a judge would have accepted the gimmickry that the FTC worked out.

EXTENSIONS TO OTHER MARKETS AND CASES

At the same time, the above analysis should not be taken to imply that national level impacts should not be considered. Even at the national level, the Getty/Texaco impacts can be estimated to raise consumer prices over $.5 billion per year through its erosion of competitive forces in the marketplace.

The Mobil/Superior merger should be modeled in much the same way as the Getty/Texaco merger. It involves the removal of an independent producer of crude from the marketplace, one which was forced to engage in open market transactions. Although Socal/Gulf involves the merger of two international majors, it too, will eliminate open market transactions. What the Chairman of Socal calls a fit between the companies is, in fact, an integration that removes oil from open market transactions and subjects that oil to transfer pricing within the company.

One can also expect dampening effects on production. The three acquiring companies have increased their domestic reserves of liquids by over two thirds and their international reserves by over one third without finding one drop of new oil. Once the FTC has applied it perverse logic of forcing divestiture of refining and marketing operations with no regard to crude, the companies will have absolutely no reason to maintain their levels of production. Why should they? Certainly not to get back into open market transactions and be forced to pay windfall profits taxes, which is one of the things they were trying to avoid in the first place?

As one examines the other aspects of the industry, the impact of these mergers are even more troubling. The impact of the mergers on the concentration of natural gas production is even greater than it is on crude oil. As one moves on to examine the refining, transportation and marketing sectors of the industry, the problems only mount.

Based on an analysis of crude oil alone, the mergers could cost consumers well over $1 billion per year due to the damage they do to the competitive forces within the industry. The selective divestiture of downstream operations without ensuring access to crude is a stop-gap measure that cannot preserve independents in the long run. Depending on the ultimate extent of reduction in competition in other aspects of the industry and what one assumes about the long run effectiveness of FTC divestiture demands, the costs will be many time that high.

Moreover, the mergers present no promising long term prospects for production. The companies have incurred a huge debt and they are highly exposed on OCS operations. While they have only 15 percent of domestic reserves, they have over 20 percent of exposure on the OCS. Just as we expect the merged Getty/Texaco firm to engage in less exploration than the two separate entities, so too we can rightly expect the three new giants to engage in less than the former six companies would have.

The mergers should also raise a great deal of concern about the international oil market. On the one hand, a great deal of oil has been acquired by companies that are partners in Aramco. Historically the Aramco partners have been among the least aggressive of the international majors. Access to Saudi crude has been their paramount concern. The removal of that oil from the open market can only weaken market forces in the worldwide industry.

On the other hand, it is widely recognized that the members of OPEC would like to move into downstream operations. The opportunity for them to do so can only be enhanced by the FTC's "prune and merge" policy. Again, the result will be a weakening of competitive forces in the industry.

Common sense, economic theory and empirical analysis clearly suggest that the public interest will be seriously hurt by these mergers. The public loses from these mergers because the resources extracted through huge price increases do not go into exploration and production activities, they go into lawyers fees, interest rates, and golden parachutes. The public loses because the weakening of competitive forces inevitably leads to less output and higher prices. The public loses because reduced taxes are one of the primary motivations for these mergers and those tax loses fuel deficits or, in the current mode, are made up with ever more regressive alternatives.

SUGGESTED REMEDIES

The solution to the breakdown of antitrust protections is remarkably simple. The necessary powers and principles have existed for quite some time within the antitrust tradition. They have simply been abandoned by the current administration.

Given the magnitude of the failure and the threat to the public interest, we cannot wait for tradition to reassert itself. When administrative agencies refuse to implement the clear intent of congress, congress must restate that intent so that the duty of the agencies cannot be shirked. It must also redefine the goals of antitrust policy to be better suited to the present stage of advanced industrial development. There are two general areas in which action is needed.

The following steps are necessary in the realm of basic antitrust policy.

o In order to reduce the immediate threat to the public interest, a moratorium is needed, one that lasts until antitrust policy can be reformulated by a special joint committee of the two houses of congress. In reformulating policy it is clear that congress will have to respecify the tests of the threat to the public interest:

o Antitrust enforcers must consider long term trends in the structure of the industry. The pattern of concentration and overall market structure during a five to ten year period should be considered and any merger that occurs in that period which causes a (cumulative) violation of the public interest test should be challenged.

- Crude oil and access to crude must be given equal consideration with downstream operations. Market-by-market analysis of crude concentration ratios and overall market structure must be made. The available crude resources to sustain divested refinery capacity must also be considered.

- If need be, a special counsel should be created to pursue cases as if they were hostile takeovers. There should be a presumption of standing in all mergers above a specific size so that arguments can proceed directly to matters of substance and drawn out battles over standing are avoided.

In addition, broader social issues and policy concerns must be addressed because the origin and impact of the recent wave of mergers lies as much outside of the industry as within it.

- The personal gains of managers in these dealings must be checked. In many instances managers are voting themselves huge windfalls when they accept a merger offer. Such arrangements must be prohibited and only independent members of the board should decide on the acceptability of the merger.

- Careful and detailed analysis of the tax implications and effects of mergers must be conducted. Loopholes which make the transfer of resources in the ground so inviting must be closed.

- The tax treatment of the financing of the mergers should also be reconsidered so that the true cost that they impose on society through the tightening of credit is borne by the merging firms. The use of unrepatriated profits to leverage loans is one major area for investigation.

- Other impacts, on geographic areas, for example, should also be considered. As these mergers cut a swath across the home towns of middle tier firms, the merging partners should be forced to bear the costs of restoring the social fiber of the affected households, just as strip miners have been compelled to bear the costs of restoring the quality of the natural environment.

I greatly appreciate the opportunity to appear before you and I would be glad to answer questions that members may have. The invitation of the Committee sought to elicit comments on the relative merits of three specific bills. The threat to the competitive heart of our economic structure is so great that we must do everything in those bills and much more.

FOOTNOTES

1. The general policy was declared by William Baxter when he was in charge of the Antitrust Division of the Justice Department. Not only did he suggest that mergers would be less harshly dealt with in general, he outlined the strategy of saving mergers by spinning off pieces of the merging companies (U. S. News & World Report, August 3, 1981). The Federal Trade Commission applied this strategy to the both the Mobil/Marathon merger and the Getty/Texaco merger. Secretary of Energy Hodel has also spoken out to support the mergers.

2. The opinion runs the full gamut from leaders of consumer groups, to business commentators, such as Allen Abelson, to industry analysts, such as Walter Levy, to the Sixth Circuit Court of Appeals in the Mobil/Marathon merger.

3. The constant plaint that a case-by-case analysis is necessary is matched only by the repeated claims that if you the government let the last one through it would be unfair not to let the next one through (see, for example, John Sawhill, New York Times, March 18, 1984 and testimony of virtually every oil industry representative before the Senate Judiciary Committee, March 15, 1984.

4. The Sixth Circuit Court of Appeals found that a wide variety of factors including size, concentration, elasticity of demand, barriers to entry, and joint operations weighed heavily against the proposed merger (669 Fed 2nd, pp. 378-385).

5. In terms of size, concentration, and barriers to entry the Texaco/Getty merger was certainly worse (see United States District Court, Northern District of Oklahoma, Civil Action No. 84-C-29E, Plaintiffs Complaint, Brief and Supplemental Application).

6. In particular, George Keller of Socal made this case before the Senate Judiciary Committee.

7. In the current environment it is all too easy to forget, downplay, or underestimate the damage that such abuse can inflict. As Harry Trebing put it ("The Chicago School versus Public Utility Regulation," Journal of Economic Issues, 10 (1976) p. 118):

> First, the effects of unregulated private monopoly on resource allocation, efficiency, innovation, and income distribution should not be minimized despite efforts to deprecate net losses due to

> allocative and "x" efficiencies [of regulation]. In the real world, the private monopolist's strategies to maintain a position of dominance through price discrimination, cross-subsidization, entry foreclosure, and political favoritism will set the stage for all of the distortions associated with monopoly power. In addition, such actions are conducive to a redistribution of income from consumers to the monopolist that may become socially and politically intolerable.

8. Although the evils of monopoly to which Trebing refers are well known, they receive little attention in current economic discussion. To briefly restate the basic concerns:

Monopolists misallocate resources. Whereas competitive markets cause just the right quantities of supplies to be produced at the lowest cost possible and sold at a price that reflects the social value of those supplies, monopolists produce less than would be supplied in a competitive market in order to raise prices. As Landes and Posner put it ("Market Power in Antitrust Cases," Harvard Law REview 94 (1981) p. 937)

> The term "market power" refers to the ability of a firm (or group of firms, acting jointly) to raise prices above competitive levels without losing so many sales so rapidly that the price increase is unprofitable and must be rescinded.

By increasing prices they rob society of goods or services that society values more than the competitive cost of producing those goods and services. They also cause transfers of wealth from consumers of the commodity to the monopolist producers.

The basic economic discussion can be summarized as follows. Exhibit 5 describes a competitive market in terms of welfare economics and Exhibit 6 describes a monopolistic market in similar terms. Total surplus is defined as the difference between the cost of producing a commodity, measured by the height of the supply curve, and the value of consuming the commodity, measured by the height of the demand curve. Every point on the supply curve is taken to represent the real costs (including normal profits) of delivering a specific quantity of a commodity under conditions of competition. Similarly, the height of the demand curve represents the value of the commodity delivered in that quantity because that is what consumers are willing to pay for it. The notion of surplus arises because the competitive process drives output to exactly the equilibrium point where the costs of production just equal the value of consumption of the last unit. Since all units are sold at a uniform price (i.e., price discrimination does not exist), some of the units of the commodity have been sold at a price above what they cost to produce and producers gain a surplus (measured as area A in Exhibit 5). Similarly, some of the units of the commodity are consumed at a price below what consumers would have been willing to pay and they reap a surplus (area B in Exhibit 5.)

Monopolists distort this picture. They endeavor to restrict supply by selling at a price that equates marginal revenue and marginal costs. In so doing, they reduce total economic surplus (by areas C plus D in Exhibit 6). They increase their surplus (by an amount equal to area E minus area D). They reduce consumer surplus (by an amount equal to area E plus C). Note that monopoly pricing makes sense for producers only where area C is larger than area E (i.e., when sales do not fall off too rapidly). As argued below, the very low demand elasticity for petroleum products suggests that monopoly pricing is very attractive to potential oligopolists.

9. In a recent summary of developments in oligopoly theory, James Friedman (Oligopoly Theory (Cambridge University Press: New York, 1983), pp. 8-9) put it as follows:

> Where is the line to be drawn between oligopoly and competition? At what number do we draw the line between few and many? In principle, competition applies when the number of competing firms is infinite; at the same time, the textbooks usually say that a market is competitive if the cross effects between firms are negligible. Up to perhaps six firms one had oligopoly, and with fifty or more firms of roughly similar size one has competition; however, for sizes in between it may be difficult to say. The answer is not a matter of principle, but rather an empirical matter. If several firms of an industry choose to ignore their cross effects (i.e., their strategic interdependence) and if demand is very elastic for each of them, with each taking its own market price as virtually given, then the industry is best analyzed as if it were competitive. Conversely, when nonzero cross effects exist, and the firms take account of them, though they may be small, then the industry is best viewed as an

oligopoly even if the number of firms is two hundred.

As argued below, the low elasticity of demand, cross effects, unequal size of firms, and history of cognizance of strategic interdependence all argue that the oil industry should be treated as an oligopoly.

10. Although Landes and Posner ("Market Power...") stated the basic issue, the critique and response to their argument actually set the framework for subsequent analysis in this discussion (see "Comments: Landes and Posner On Market Power, Four Responses," Harvard Law Review, 95 (1982)).

11. The issue of geographic market definition received considerable attention in the critique cited in note 10.

12. Claude Ponsard, History of Spatial Economic Theory (New York: Springer-Verlag, 1983) outlines the deep theoretical roots of this type of economic explanation. In a sense, netback pricing continues to be a form of this approach to analysis. The difficulty is that most analysts simply assume that all prices are Saudi netback prices instead of recognizing the fact that, depending on the balance of economic forces the price could be netbacked from the local market.

13. The argument with respect to the West Coast, based on its geographic isolation and the impact that isolation has on the price mechanism has been identified by a number of analysts in the form of a West Coast discount on crude oil prices. Mark Cooper, The Consumer and Energy Impacts of Crude Oil Exports (Washington, D.C.: Consumer Energy Council of America, March, 1982) reviews the conceptualization and the empirical measurement of this characteristic of the market including its impact on prices. Mark Cooper, The Oil Product Price Mechanism, before the Subcommittee on East Asian and Pacific Affairs of the Committee on Foreign Affairs, United States Senate, 98th Congress First Session, July 22, 1984, presents a general theoretical discussion and an empirical econometric model of this price mechanism.

14. The critique of Landes and Posner and the Sixth Circuit decision provide excellent discussions of these factors.

15. The history of imperfections in the oil market has been discussed in detail in John Blair, The Control of Oil (New York: Vintage Books, 1976).

16. Much of Blair's analysis (The Control...) is based on testimony presented to the congress. OPEC activities and oil

company activities in the late 1970s were also analyzed before the congress. A thorough compilation of this documentary record can be found in the source materials cited in Steve Schneider, The Oil Price Revolution (Baltimore: Johns Hopkins University Press, 1983).

17. The importance of economic rents is stressed by Blair (The Control...). Even Paul MacAvoy (Crude Oil Prices: As Set by OPEC and Market Fundamentals (Cambridge: Ballinger, 1982) p. 21) admits the existence of rents.

18. Actual prices are taken from MacAvoy (Crude Oil...) and Blair (The Control...).

19. Exploration costs in the U. S. are running at about $15 per barrel at the extreme margin. This is not the marginal cost in a competitive market, since, if no production were being shut in, the market would clear far below that level. Thus, a real cost of $7 per barrel at the margin is extremely generous.

20. In 1973 the costs in Alaska were somewhat higher than this. However, in a fully competitive market it is unlikely that Alaskan oil would have entered the market.

21. Theodore Moran, "Modeling OPEC Behavior: Economic and Political Alternatives," in James M. Griffin and David J. Teece (Eds.), OPEC Behavior and World Oil Prices (London: Allen and Unwin, 1982) presents the theoretical price paths as described in Exhibit 7.

22. It should be noted that the 1946 cost estimate is probably too high as well. Cartel practices had been in place for almost two decades at that time and the observed costs certainly already embodied artificial price enhancement.

23. The source of much of this argument is the Pennzoil complaint cited in note 5.

24. See note 13.

25. Texaco's weaknesses and difficulties relative to other international major oil companies were widely noted in the aftermath of the proposed merger. Press accounts in the New York Times (January 15, 1984), Oil and Gas Journal (October 17, 1983) and The Wall Street Journal (January 10, 1984) make this point.

Texaco, with one third greater production of crude than Getty in 1982, had one sixth less reserves. International majors on the West Coast are in a much stronger position, especially those with Alaskan reserves. Estimates of the costs of additional reserves experienced by Texaco and Getty have been entered into evidence in Pennzoil Company v. Texaco, Inc.... Texaco's costs are estimated at $14.36 per barrel (Verified Complaint, p. 13). Getty's costs are estimated at $19 per barrel (Verified Complaint, p. 14). The purchase price for Getty is about $8 per barrel.

Texaco's share of domestic production was one sixth higher than its share of domestic reserves. Its share of reserves and production on the West Coast appears to have been lower than all of the international majors (see Frank Camm, et al., Effects of A Severance Tax on Oil Produced in California (Santa Monica, Ca.: The Rand Corporation, 1982) p. 20.

About half of Getty's production takes place on the West Coast. Pennzoil Company v. Texaco, Inc... (Plaintiff's Brief p. 18) gives the Getty share of domestic production of 2.7 percent in 1982. This indicates about 100 million barrels of production. Camm, et al., Effects of..., gives Getty production on the West coast of about 45 million barrels.

26. The elasticity of demand for petroleum products in the United States appears to be considerably less than one. Calculating a weighted average elasticity of demand based on Douglas Bohi, Analyzing Demand Behavior: A Study of Energy Elasticities (Baltimore: Johns Hopkins University Press, 1981), with California usage patterns providing the weights, yields an elasticity of -.64.

27. Supply elasticities are estimated to be even lower. Paul MacAvoy, (Crude Oil Prices...) uses an elasticity of supply of .4 for the world market. The elasticity of supply for the United States should be much lower. Joseph Kalt, The Economics and Politics of Oil Price Regulation: Federal Policy in the Post-Embargo Era (Cambridge, Mass.: The MIT Press, 1981) uses supply elasticities of .2 in the short term and .5 in the long term for the United States. In subsequent analysis, the elasticity of demand is set at -.64 and the elasticity of supply is set at .4.

28. Frank Camm, et al., Effects of a Severance...) gives the California production figures. Alaska North Slope production figures are widely available. Exhibit 7 gives the market shares used for the present analysis.

EXHIBIT 1

A MEASURE OF PRICE DISTORTION UTILIZING NUMEROUS MARKET CHARACTERISTICS

$$L_i = P - C/P = S_i\ (1 + k)/(e_d + S_f e_f)$$

where: L_i = the Lerner index, i.e. the percentage by which prices exceed marginal costs

P = price

C = cost

S_i = market share of individual firm

k = measure of the market response;
k = o is neutral,
k = - means the market moves in the opposite direction
k = + means the market moves in the same direction

e_m = the elasticity of market demand

S_f = market share of the competitive fringe

e_f = elasticity of supply of competitive fringe

To put this equation in words

Price Distortion =

$$\frac{\text{Market Shares of Firm} \times (1 + \text{Direction of market response})}{\text{Ability to reduce demand} + (\text{Market Share of the Fringe} \times \text{Ability of Fringe to increase supply})}$$

EXHIBIT 2

THE CONDITIONS FOR THE PERSISTENT CARTELIZATION OF THE WORLD OIL INDUSTRY

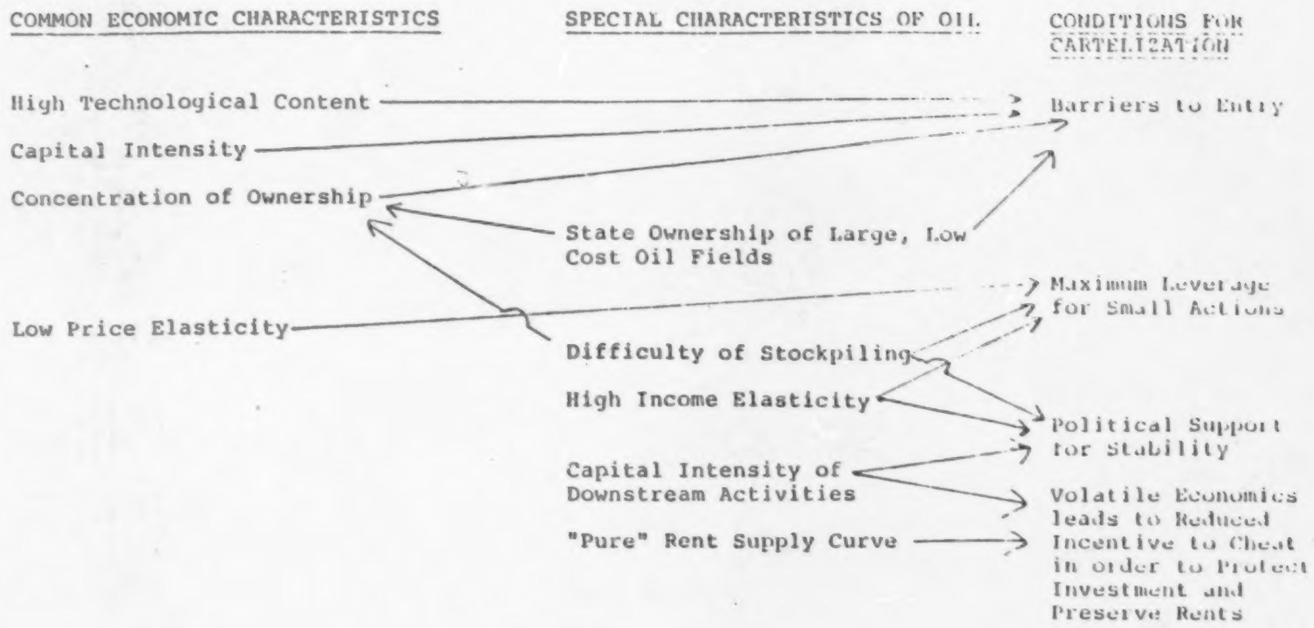

COMMON ECONOMIC CHARACTERISTICS
SPECIAL CHARACTERISTICS OF OIL
CONDITIONS FOR CARTELIZATION
High Technological Content
Capital Intensity
Concentration of Ownership
Low Price Elasticity
State Ownership of Large, Low Cost Oil Fields
Difficulty of Stockpiling
High Income Elasticity
Capital Intensity of Downstream Activities
"Pure" Rent Supply Curve
Barriers to Entry
Maximum Leverage for Small Actions
Political Support for Stability
Volatile Economics leads to Reduced Incentive to Cheat in order to Protect Investment and Preserve Rents

EXHIBIT 3
A COMPARISON OF ACTUAL WELLHEAD PRICE AND ESTIMATED MARGINAL COST SINCE WORLD WAR II

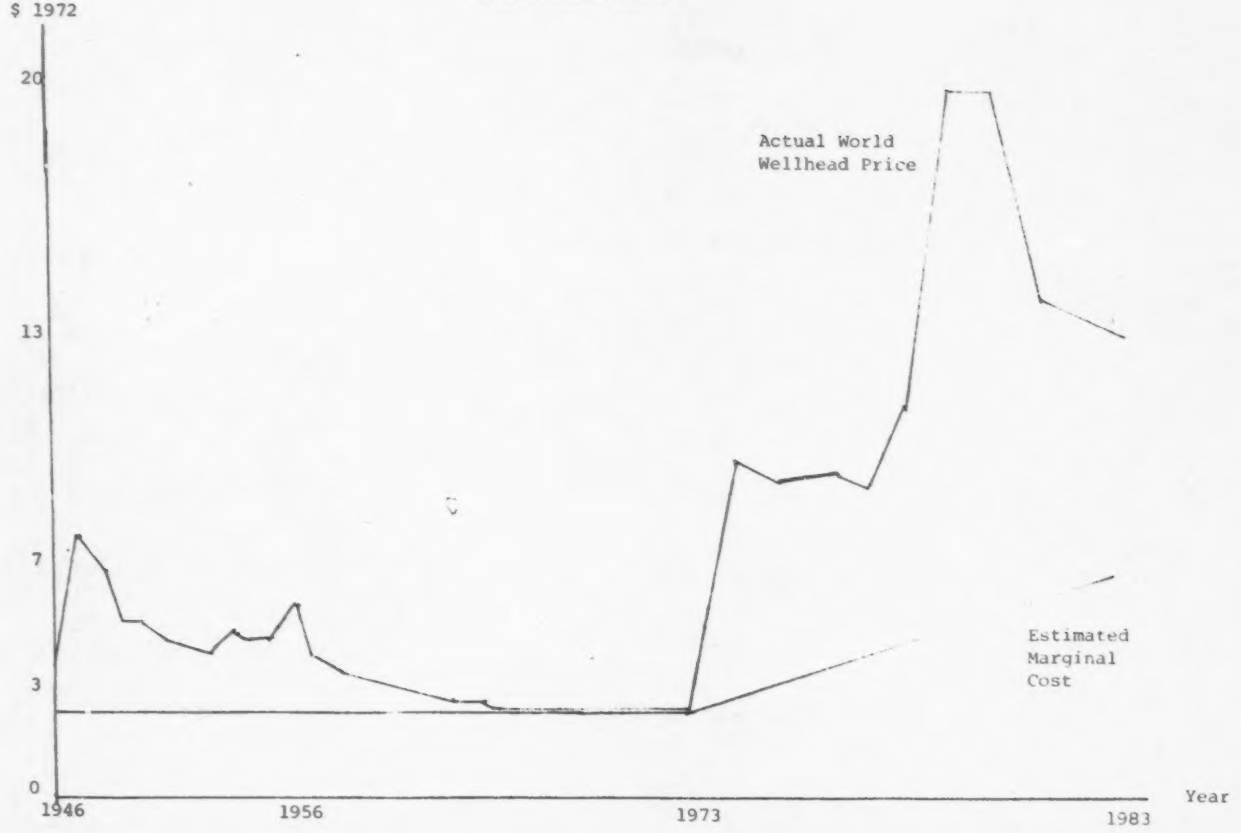


EXHIBIT 4

ESTIMATES OF THE IMPACT OF THE GETTY/TEXACO MERGER UNDER VARIOUS ASSUMPTIONS ABOUT ITS IMPACT ON THE STRUCTURE OF THE WEST COAST CRUDE OIL MARKET

Model	Percentage Point Increase In Price Distortion	Dollar Value of Price Distortion ($ millions)
Simple Herfindahl Index	.22	44
No Fringe, Change in the Direction of Market Response		
Small Change	2.70	540
Large Change	5.15	1030
No Change in the Direction of the Market Response, Getty Removed from the Fringe		
Large Fringe	.68	136
Small Fringe	1.04	208
Getty Removed from the Fringe and Change in the Direction of the Market Response		
Large Fringe, Small Change	2.72	544
Large Fringe, Large Change	4.72	944
Small Fringe, Small Change	3.43	686
Small Fringe, Large Change	5.83	1166

Notes:
The numerator of the fraction is .1564 (i.e. the HHI=1564) prior to the merger. The Texaco market share is 1.38 percent and the Getty share is 5.06 percent. Consequently, the numerator of the post merger market is .1578. Demand elasticity is -.64. Supply elasticity is .4. A small change is modeled as k=0 to k=.1. A large change is modeled as k=0 to k=.2. A large fringe assumes that all nonAlaska North Slope producers compete, which yields a fringe of 40 percent. A small fringe assumes all nonmajor, nonAlaska producers compete, which yields a fringe of 11 percent. The supply elasticity of the fringe is assumed to be .4 regardless of its size. The gross value is estimated assuming a total crude bill of $200 billion per year, which is based on an assume 2.4 million barrels per day at $22.83 per barrel.

EXHIBIT 6

COMPETITIVE PRICES AND ECONOMIC SURPLUS

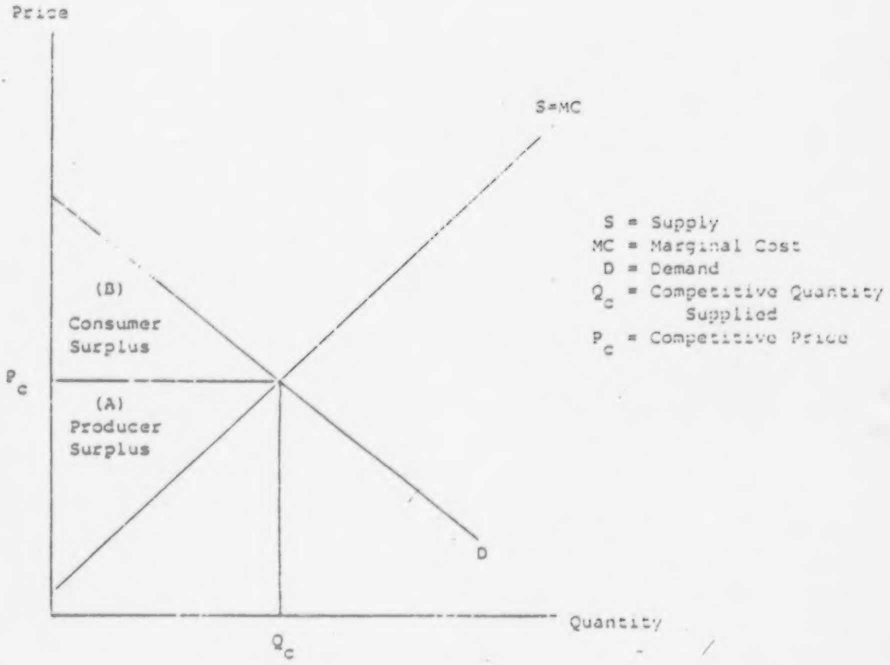


EXHIBIT 6

MONOPOLY PRICES AND
ECONOMIC SURPLUS

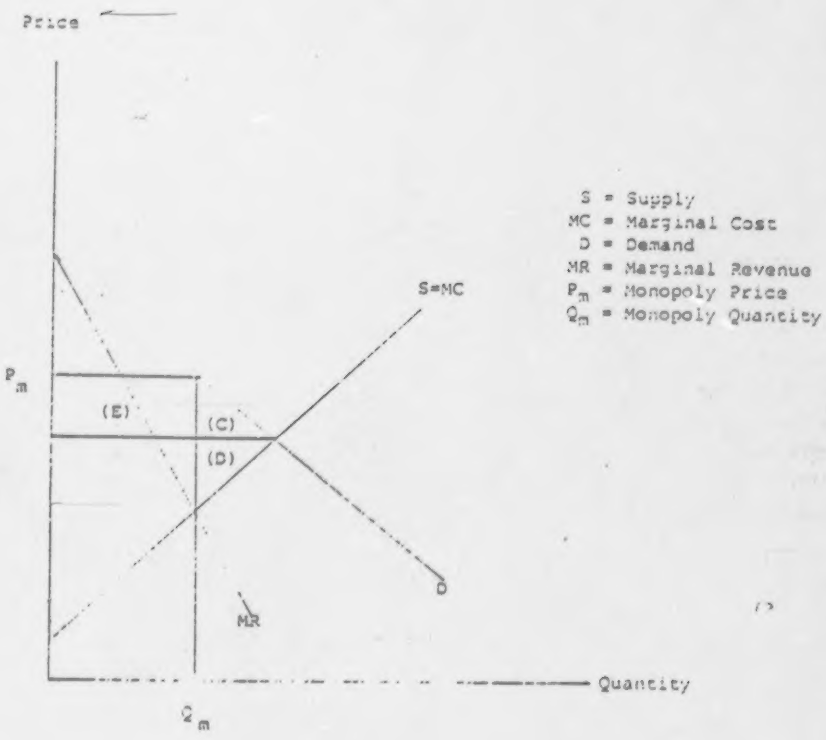

Price
S = Supply
MC = Marginal Cost
D = Demand
MR = Marginal Revenue
P_m = Monopoly Price
Q_m = Monopoly Quantity
S=MC
P_m
(E)
(C)
(D)
D
MR
Quantity
Q_m

EXHIBIT 7

CRUDE OIL PRODUCTION SHARES ON THE WEST COAST

COMPANY	PERCENT OF MARKET
Sohio	32
Exxon	14
Arco	14
Williams	7
Shell	6
Getty	5
Chevron	4
Thumbs	2
Union	2
Mobil	2
Texaco	1
Santa Fe	1
Aminoil	1
Tennoco	1
Sun	1
Gulf	1

STATEMENT OF MICHAEL S. KIRSCHNER, CHIEF EXECUTIVE OFFICER, KIRSCHNER BROS. OIL CO., ON BEHALF OF THE SOCIETY OF INDEPENDENT GASOLINE MARKETERS OF AMERICA

Mr. KIRSCHNER. Thank you, Mr. Chairman. My name is Michael Kirschner. I am the chief executive officer of Kirschner Bros. Oil Co. in Haverford, PA, and president of the Society of Independent Gasoline Marketers of America [SIGMA], on whose behalf I appear today. SIGMA is a trade association comprised of approximately 250 independent marketers, mostly privately owned.

SIGMA's members operate in 49 of the 50 States and their sales constitute approximately 15 percent of the domestic retail gasoline sold. SIGMA's members have been recognized by their peers, both major oil and independent types, as being among the most innovative and efficient retailers of motor fuels in the world. Our members have pioneered such cost saving techniques as self-service and the high volume/ low margin pumper marketing concept.

As a result of their innovations and other cost efficiencies, SIGMA's members have been able to minimize the amount of operating costs in a service station, and offer product to the motorist at the lowest possible prices.

The Government has become aware in conducting these interviews and many others of the trend of mergers among the major oil companies. I would like to comment on how those mergers could possible affect the independent marketer. The independent marketer relies upon independent supplies of gasoline to operate its service stations.

As the control of crude oil is placed into fewer and fewer hands, the independent refiners of that crude oil are having a more difficult time in surviving in the market place. Two of the most efficient companies, Powerine and Hill, have recently filed for bankruptcy and many trade journals, including the prestigious Wall Street Journal, have described the ailments of both Tosco and Trotter Oil, two also prestigious, highly efficient, well-run independent refiners.

Without competitive priced product, it will be impossible for SIGMA's membership to pass on the efficiencies that their station operations have to the motorists and to the public. Consequently, the same ailments that are falling upon the independent refining segment will probably happen to a portion of the SIGMA membership.

The Government in its analysis——

Senator WARNER. Would they be treated any different than they are?

Mr. KIRSCHNER. One egg follows the other. The Government in its analysis of the trend has concentrated mostly on the effect of retail refining and marketing outcome. So far the remedy has been for certain companies, the surviving companies, to give up portions of its acquired or previously owned retail assets primarily service stations and refineries.

However, no definition has been ever set so far to what should happen to the crude oil that has been acquired. One company recently in its merger was instructed to divest itself of a portion of the retail assets that it had acquired and was also instructed to divest the refinery, and the only effect on crude oil was that it was determined that the company, the surviving company should supply crude oil for a 5-year period to one regional market. Five years in the life of an oil company, independent or non, is a very short period of time.

Just saying that a company divesting certain retail assets, whether it be refining or marketing, eliminates all of the problems of lack of competition that the mergers are bringing about, seems to me to be the wrong way to approach the problem. Therefore, SIGMA would like to see the endorsement of S. 2362 so that the Congress will have an opportunity to study the matter in depth, so that the pistol will not be pointed at the temple to meet FTC and SEC and all types of other deadlines that the mergers are bringing.

We have no argument with any one merger, but we do have an argument with the trend, where it will lead us down the road. We want the structure of competition not to be damaged by the outcome of the merger and, therefore, we support the concept of S. 2362 so that this country will have an opportunity to evaluate what the merger of what we consider to be its natural resource, crude oil, into the hands of fewer companies will produce.

Thank you for the opportunity.

[The prepared statement of Mr. Kirschner follows:]

Before the
Committee on Energy and Natural Resources
of the
United States Senate

Testimony of
Michael S. Kirschner
on behalf of the
Society of Independent Gasoline Marketers of America

Regarding S.2362 and Oil Company Mergers

April 10, 1984

My name is Michael S. Kirschner. I am Chief Executive Officer of Kirschner Brothers Oil Company in Haverford, Pennsylvania, and President of the Society of Independent Gasoline Marketers of America on behalf of which I appear today. SIGMA is a trade association comprised of approximately 250 independent marketers and chain retailers of motor fuels. SIGMA's members operate in 49 of the 50 states and their sales constitute between 10 and 15 percent of the domestic retail market for motor fuels.

SIGMA's members are recognized as being among the most innovative and efficient retailers of motor fuels in the world. They pioneered such cost-saving techniques as self-service and the "high volume/low margin" marketing concept. As a result of their innovations and other cost efficiencies, SIGMA's members are able to minimize the amount of operating costs which must be recovered in the per unit price of motor fuels. This ability has enabled them to offer product to the motorist at the lowest possible price.

A chain retailer's efficiencies are relevant in his market only to the extent that he can obtain product at the wholesale level at a price which is roughly comparable to the cost incurred by his competitors. The Association always has viewed an intensely competitive wholesale market as the best insurance that its members' operating efficiencies will remain relevant in the retail market. It is SIGMA's concerns regarding the implications of the recent wave of mergers within the petroleum industry that brings me here today.

At the outset I must note that SIGMA's greatest concern is not with any particular proposed acquisition. Rather, the Association's members are alarmed by the trend towards increased concentration in our industry and the direct implications of that increased concentration for competition at the wholesale level, i.e., the level at which we buy, as well as its implications for competition at the retail level in which we participate. It is our fear that the consolidation of crude oil reserves in the hands of fewer and fewer companies may have a devastating effect on competition at the wholesale level by: (1) further endangering the competitive viability of independent refiners, and (2) effectively eliminating some refineries, currently operated by companies being acquired, as viable sources of competitively-priced product.

Recent operating results in the petroleum industry clearly indicate what most of us have believed all along, i.e., that the control of crude oil supplies is the key to economic survival in the refining industry. During the last three years, profits of refining and marketing operations have been simply abysmal. Independent refiners have left the market in large numbers. For the most part, those refiners were not sophisticated processors of crude oil. However, even some of the most sophisticated independent refiners have experienced overwhelming financial difficulties. As examples of this phenomenon I would urge the Committee to take note of Tosco's well-publicized financial difficulties and the recent bankruptcies of Powerine and Hill Petroleum. We believe that the failure of sophisticated independent refiners to achieve tolerable levels of operating profitability is directly attributable to their inability to obtain crude oil at a cost which, when added to their processing costs, permits them to sell refined products at a price which will allow them to compete with their integrated competitors. In contrast, companies which control substantial reserves for crude oil have generated sufficient profits in areas other than refining and marketing to enable them to increase their market share. Thus, we are forced to the conclusion that only those companies which control substantial reserves of crude oil can be viewed over the long term as reliable sources of competitively-priced petroleum products.

If our conclusion, that a supplier's long-term viability is dependent upon its control of substantial reserves of crude oil is correct, then the recent trend toward the concentration of those reserves is ominous. Refiners who control increased percentages of domestic reserves will increase their relative strength in the marketplace at the expense of their non-integrated competitors. As a probable result, competition will be reduced at the wholesale level and thereby generate reduced competition at the retail level.

As recent history has demonstrated, the possession of refining capacity, even sophisticated refining capacity, is not an assurance that a manufacturing entity can remain viable as a competitor at the wholesale level. Thus, an analysis of any particular proposed acquisition, or series of acquisitions, based solely on market share or market overlaps does not guarantee a real understanding of the potential competitive consequences of such acquisitions. Simply stated, the approval of a particular acquisition on the condition that certain assets of the acquired company be alienated does not insure that the structure of competition will be preserved. It must be recognized that the competitive viability of those assets is a function of the capabilities and assets of their owner. Thus, without knowing the identity and resources of the entity which proposes to acquire divested assets, it is impossible to predict the effect on competition of an acquisition conditioned on such divestiture.

If divestiture of particular assets is essential to the government's approval of a particular acquisition, then we believe it is absolutely critical that the divestiture of those assets be accomplished in a manner which reasonably insures that their operation will be a competitively viable enterprise. Absent such an assurance, the probable result of the acquisitions currently contemplated is an overall reduction in operating refining capacity and a concurrent reduction in competition at the wholesale level. Given the crucial role in maintaining competition played by the capabilities of the entity acquiring divested assets, the only means by which to receive such an assurance is to know in advance the identity of that entity. Absent this knowledge, we are simply rolling the dice with the structure of competition in particular markets.

SIGMA recognizes that the potential dire consequences which we fear may result from increased concentration of control over crude oil reserves, may not come to pass. The proposed transactions are of such enormous magnitude that we are unable to analyze all of the implications. Yet, it is crucial that Congress have the opportunity to consider those implications. SIGMA endorses the concepts contained in S.2362 because the bill, if enacted, would effectively provide Congress with that opportunity. Thus, the Association urges Congress to act effectively to slow what appears to be an accelerating trend towards concentration in the industry.

In summary, the competitive viability of independent marketers is totally dependent upon their ability to obtain competitively-priced product at the wholesale level. It appears that the viability of wholesale suppliers is conditioned, to an increasing extent, upon their access to controlled crude oil reserves. The consolidation of domestic reserves into fewer and fewer companies raises significant questions regarding the long-term viability of refiners who do not possess such reserves, and as a result, raises questions about the structure of competition at the wholesale level and indirectly the retail level. Thus, it is essential that acquisitions such as those contemplated today be approved only under circumstances which assure, as a practical as well as theoretical matter, that the structure of competition will not be damaged.

SIGMA appreciates this opportunity to express its views on this matter. I will be happy to respond to any questions which my testimony may have raised.

STATEMENT OF LARRY NAPOLEON COOPER, CHIEF EXECUTIVE OFFICER, PROJECT 76, AN AMERICAN AFFAIR, INC.

Mr. Cooper. Thank you. My name is Larry Napoleon Cooper, short for "Boog-a-loo," which is my stage name for politics.

Honorable members of the committee, it is with some feeling of accomplishment that I appear before the U.S. Senate committee and say in this appearance, I told you so.

The main thrust of Senator Johnston's anti-oil merger proposal is to neutralize a force, competition, that has forever controlled economies the world over by denying a very few merging American oil companies access to federal lands for energy exploration and production purposes.

It is with considerably increased respect for this great body that I commend the U.S. Senate for its temporarily resounding defeat of this ill-considered measure counterpart idea, the moratorium.

Some horizontal and vertical conglomeration of America's threatened industry is inevitable as are the calls for import restrictions that will continue the exploitation of American consumers. Between previous appearances and now, international economic reality has caught up with America. High quality and low prices of consumer products imported from foreign economies now limits the quality and price abuse of the American consumer by domestic labor, capital and management. Should the Senate, after its 90-day study of the issue and review of the unpleasant facts not see the fact that international competition, fair and otherwise, mandates new industrial action, especially mergers, the competitiveness of our economy in these threatened industrial sectors will continue to evaporate along with America's historic free enterprise leadership position in the world.

The new, more reasonable way of approaching this problem, which I speak of here today, is not prohibiting *X* oil companies from exploring for already diminished energy resources on Federal lands to keep them from merging. That is a step backward and would likely lead to eventual ownership of American oil companies, downstream refining, distribution and retailing assets by foreign, probably Middle Eastern, governments. They, of course, would be exempt from Senator Johnston's Federal lands deal, having their own 100-year supplies of raw energy material.

No American wants retail service station prices and supply availability determined by OPEC. National security alone mandates a consideration of the new approach I lay before you today.

I do not think that consumers, taxpayers and employees alone should bear the brunt of the unemployment, higher taxes and higher prices at the gas pump that would inevitably result from this antioil merger legislation. While the merger actions of oil and other companies are now inevitably being forced upon them, it is because they have failed until now to confront the consequences of too much labor, idle capital, and diminished opportunities.

The traditional approach to solving these problems requires mergers. However, after the mergers are completed, companies must then fire overlapping employees and increase the productivity of those employees and capital funds that remain. They cannot do this in oil and gas because of the limited availability of significantly new energy related business opportunities anywhere in the United States.

Therefore, unless the companies can expand and reach out further with the combined companies and add to their product and service line, they must shrink even further.

In the State of Louisiana, this inevitably represents an especially heavy burden. We have gone from one of the lowest taxed States in the Union to one of the highest almost overnight and from being among those with the lowest rate of unemployment to being among those with the highest.

Accordingly, I am here to offer for your review a just alternative to Senator Johnston's self-serving merger legislation that makes painless the collective medicine that must be taken.

Admittedly, his legislative initiative would be politically expedient except that it indirectly offers the alternative of yanking from under the entire economy, consumer and business alike, the longstanding deductibility of interest payments on borrowed funds.

Would it not appear convenient in this election year for those in the Congress who have done little to promote real competitive responsibility on the part of America's capital, labor and management to now propose either, one, that threatened American industry be prohibited from merging and, thus, proceed with its headlong fall further from worldwide superiority in commerce industry; or

Two, that the companies merge in the old way which dumps the waste of management, capital and labor in the form of unemployment squarely at the feet of society?

In my view, merging and dumping the overlapping employees upon the remaining smaller taxpaying base would surely lead to higher taxes and even less productivity and competitiveness, while pressure at the polls would mount significantly for Government intervention and price controls.

I am here today, Mr. Chairman, because almost no one over the last 10 years has seen fit, especially my self-serving Senator from Louisiana, to acknowledge or to promote the painless alternatives of utilizing and conglomerating the third, nonprofit sector industry.

Yet, Senator Johnston's legislation would, and in its own way already has, prohibited Project 76, An American Affair, Inc., hereafter referred to as the 76 Project, from doing just that. His proposed legislation and its dangling threat to continued interest deductibility, in fact, prohibits the 76 Project, a public charity, from acquiring many companies among America's threatened industrial sector, specifically certain U.S. oil and gas distribution, processing and retailing assets, on terms favorable to management, capital and labor.

When the news broke of Senator Johnston's proposed moratorium on oil and gas mergers, I on behalf of the 76 Project was actively involved in friendly discussions with Salomon Bros. to acquire the Gulf Oil Corp.; also with Texaco's management to acquire many of the oil and other assets of Texaco, and later the Superior Oil Corp.

I ultimately abandoned these talks, which were already going slowly, because of the nonprofit nature of the transaction and the uniqueness of a tax exempt proposal that meant buying out the stockholders, taking the purchased companies private nonprofit and then merging them and operating them subsequently solely in the general public interest as defined by official government action at the Federal, State, and local level.

The question of continued interest deductibility brought to light by the Senator's initiative on top of the proposed acquisitions already established uniqueness of approach, queered and ultimately caused me to discontinue those talks. Afterwards I undertook to outbid Socal for Gulf, buy the combined Texaco and Getty oil operations and subsequently outbid Mobil for Superior. However, the uncertainty of future exploration and production opportunities available to merged companies put an uncertain chill on capital sources that would otherwise have been leaping to finance even the 76 Project's hostile acquisition of the properties in question.

Gentlemen, as chief executive officer and spokesman for the 76 Project, I can tell you that I have been waiting for some ten years for the reality of, and in many cases, subsidized foreign competition to force American industry to consider this simple but extremely effective new industrial ownership approach for threatened sectors.

For example, I made an effort to acquire the Getty Oil Co. from Mr. J. Paul Getty in 1975, documentation attached and submitted for the record will confirm this. But at that time the bud on the rose of the energy industry was simply too encouraging for anyone to sell out at a reasonable price. The bubble has finally burst. Most oil companies will either merge, like steel, electronics manufacturing and distribution, et cetera, be bought out by the Government or simply go bust with stockholders and the economy losing heavily.

This is why the 76 Project and I stepped in to utilize the new alternative, buy these companies, take them private, nonprofit and operate them in the public interest and be obligated to retain and actively utilize in the public interest all overlapping employees who as a result of the Senator's scare——

Senator WARNER. I am going to interrupt just a minute, Mr. Cooper, just so you understand. In fact, I voted with Senator Johnston the first time and against him the second time. My understanding is you are an announced candidate against Senator Johnston.

Mr. COOPER. Yes, I am.

Senator WARNER. We are here to receive testimony on this issue and I will ask you to contain your remarks only to the substance before this committee and leave out personal references to our distinguished colleague.

Mr. COOPER. Your admonition is taken in good spirits, Senator. But you, of course, would be the first to say that the hearing process and the introduction of legislation and what have you is on many occasions spearheaded by objectives in the election process back home. Now, in that the Senator's initiatives in this area impact directly upon the business I have undertaken on behalf of myself and these public charities on whose behalf I am speaking, it would appear unfair on the surface to hold him directly accountable for his actions.

Senator WARNER. How you wish to hold him directly accountable is not at issue in this hearing. As chairman, I have control over this record which contains all references pro and con for the business before the committee. We will not use it for political advantage, or use it to cast any disparaging remarks to anyone on this committee.

Mr. COOPER. A point well taken. There are no cameras here and this will not go beyond this room.

Senator WARNER. This is a public record open for examination by all.

Mr. COOPER. A point well taken.

Senator WARNER. You are here for the purpose of enlightening this committee with respect to your views on the issue of mergers and we are prepared to receive that.

Mr. COOPER. Senator, the main reason that I am here is because Project 76 and American Affair, Inc. had a very nice series of negotiations underway to acquire oil and gas assets. The Senator's, and I will not use his name, intrusion into this private business through his legislative initiative, which I don't hold you personally responsible for joining, has underminded what we are trying to do and the purpose of this testimony is to show that the suffering caused to our initiative will prevent these companies from being acquired on a basis favorable to the public interest.

Senator WARNER. You are at liberty to do that, but when you refer to it as a scare tactic, the Chair will rule that you not do that here, since you are an announced candidate against him. I am sure my colleagues would do that also.

Mr. COOPER. I was in the oil business for 10 years when I decided the only way to get at this issue was politics, to get to the issue at hand, and I will delete references to the junior Senator from Louisiana. This is why the 76 Project and I stepped in to utilize the new alternative to buy these companies and take them private and nonprofit, operate them in the public interest and be obligated to retain and actively utilize in the public interest all overlapping employees who will now as a result of this legislative initiative have been fired by the acquiring companies and make many of their previous work sites permanently closed.

Congress should not stand for this old approach. It should perceive and utilize the new recommended course of action.

Can it not be argued that if the Senate can, in fact, encourage the 76 Project to proceed with its acquisition in oil and other threatened industrial sectors in a manner that does not displace workers or continuously reduce product and service competitiveness that it should?

To do so, the Congress would simply have to find such nonprofit acquisitions in the public interest by resolution. No other legislative action would be required. Utilizing this approach would reduce long-term deficits at a rapid pace, hand-in-hand with increased services provided in the public interest outside the Government appropriations process. Every sector of society, capital, management, and labor, would as a direct result benefit.

To add real teeth to any such resolution, the Congress should put on its agenda a constitutional amendment that prohibits—or that provides that except in emergencies to be determined by a simple majority where the private nonprofit funding and administration of Federal programs designed to achieve educational, economic, foreign aid, social or efficiency benefits in the public interest is not available, the deficit expenditure and/or Federal budget appropriation of tax revenues by the Congress of the United States for such purposes is prohibited. These services on a competitive basis would then be financed and administered by the private third nonprofit sector.

We all know what would happen then. The size of government would decline at a rapid pace, while the productivity of public servants shifted, not fired, to the private third nonprofit sector would dramatically increase. We can all speculate that in the private sector, the quality and quantity of available public works, service, social welfare, educational and foreign aid activities provided by these workers would then dramatically increase.

As we all know, there are generally two ways of reacting to a problem of this nature in an election year, the expedient way and the just way. Loss of competitiveness is but another simple problem with an equally simple solution. One that does not require one-third of the problem, the workers, to suffer 100 percent of the cost through unemployment.

In light of the availability of the new approach, would it not be unjust to cause mass firings of employees in the private and public sectors as are now occurring unnecessarily in the State of Louisiana and throughout America? Will this pain not fall squarely on low level employees, especially black ones, allowing both capital and management to virtually escape judgment?

Cannot the Congress of the United States perceive that a valid option exists? Why, when the Congress could free the third nonprofit sector by simple resolution can it not launch the U.S. economy in short order toward required industrial and manufacturing superiority? Should labor through unemployment; taxpayers, through more taxes spread over fewer taxpayers; and consumers, through tariff-ridden higher purchase prices for goods, pay the unnecessary and totally unfair dues of the whole industrial society?

Will Congress not see the dramatic increases in productivity realized in America's per man hour job performance since the onset of this, to some, ongoing recession? Does it fail to see that workers have learned that the American consumer will spend where the highest quality and best price is, regardless of what foreign land is responsible?

Americans are now taking considerably more pride in their job performance but they cannot do it alone. Should not management, capital, and government be made to feel their fair share of the true bite of competition?

I ask, is there consequently not a very real political threat to those identified as responsible for collectively placing the total burden of taking the medicine on the helpless worker and taxpayer? Management and capital, in and out of government, should no more be able to avoid mandated increases in productivity than labor and employees.

Nothing less than the future of society is at stake. Should not the Congress utilize the painless new approach outlined herein while simultaneously freeing the economy, stopping tax increases, and ushering in a wave of prosperity and unspent creativity throughout America? Congress is wed after all by the constitution of the

United States to the protection of its citizens from foreign and domestic brutality, economic and military.

Congress must perceive that we are well aware as civic-minded citizens and third nonprofit sector businessmen that to simply catch our collective economic breath before we all drown will simply not do.

Thank you.

[The prepared statement of Mr. Cooper follows:]

STATEMENT

BY

MR. LARRY NAPOLEON COOPER

FOUNDER, CHIEF EXECUTIVE OFFICER, AND SPOKESMAN

PROJECT 76 - AN AMERICAN AFFAIR, INC.
(A 501(C)(3) PUBLIC CHARITY)

LARRY N. COOPER THE PROPRIETORSHIP

ASSOCIATION FOR AMERICAN ACHIEVEMENT THROUGH ACTION
FOR THE ADVANCEMENT OF AMERICANS OF AFRICAN ANCESTRY

AND

REPUBLICAN CANDIDATE FOR THE U.S. SENATE FROM LOUISIANA

1519 PEABODY STREET
SHREVEPORT, LOUISIANA 71103
(318) 221-5670

BEFORE

THE ENERGY AND NATURAL RESOURCES COMMITTEE
OF THE UNITED STATES SENATE
WASHINGTON, D.C.

APRIL 10, 1984

In Testimony on Legislation Proposed by Senator J. Bennett Johnston to Restrict the Access of Certain Merging United States Oil Companies to Federal Lands and Energy Producing Opportunities.

Honorable members of the Committee.

It is with some feeling of accomplishment that I appear before a United States Senate Committee and say in this reappearance, I told you so.

The main thrust of Senator Johnston's anti-oil merger proposals is to neutralize a force (competition) that has forever controlled economies the world over by denying a very few merging American oil companies access to federal lands for energy exploration and production purposes.

It is with considerably increased respect for this great body that I commend the U.S. Senate for its temporarily resounding defeat of this ill considered measure..

Some horizontal and vertical conglomeration of America's threatened industry is inevitable, and assured the more so by calls for import restrictions that will continue the exploitation of American consumers by labor, management and capital. Between my many previous appearances and now, international economic reality has caught up with American government and industry even more than I warned many of you, especially Senator Johnston, in late 1977 and early 1978 would be the case.

I say without reservation that the high quality and low prices of consumer products imported from foreign economies will continue to prohibit the quality and price abuse of the American consumer by domestic labor, capital and management. Should the Congress, after its 90-day study of the issue, these hearings, and a review of the unpleasant facts they will inevitably produce, continue to ignore the fact that international competition (fair and otherwise) mandates new industrial action, including and especially mergers, in all threatened industrial sectors, the competitiveness of our economy in these threatened industrial sectors will continue to evaporate along with America's historic free enterprise leadership position in the world of business.

On the other hand, because there is a new more humane way of approaching this problem, prohibiting X Oil Company from exploring for already diminished energy resources on federal lands to keep them from merging represents a step backward and will only lead to eventual ownership of American oil companies -- especially their downstream refining, distribution and retailing capabilities -- by foreign (probably Middle Eastern) governments that possess their own 100-year supplies of energy resources. No American wants retail service station prices and supply availability determined by OPEC. Consequently, our national defense and security alone mandate a consideration of the new approach I lay before you today.

I do not think that consumers, taxpayers and employees alone should bear the brunt of the unemployment, higher taxes, and higher prices at the gas pump that would inevitably result from anti-oil merger legislation. While the merger actions of oil and other companies are now inevitably being forced on them, it is because they have failed until now to confont the consequences of too much labor, idle capital and spreadsheet management (diminished opportunities).

The traditional outdated approach to solving these problems requires mergers. After the mergers are completed, companies must then fire overlapping employees and increase the productivity of those employees and capital funds that remain, which they cannot do in oil and gas because of the limited availability anywhere in the U.S. of new energy related business opportunities. Therefore, unless the companies can expand the scope and reach of the combined companies' product and service lines, the only option, unless the new approach suggested herein is used, is to shrink further the size of management, capital and labor on hand.

In the state of Louisiana, this inevitably represents an especially heavy burden. We have gone from one of the lowest taxed states in the union to one of the highest almost overnight, and from being among those with the lowest rate of unemployment to being among those with the highest. Accordingly, I am here to reappear and in testimony offer for your review a just alternative to Senator Johnston's self-serving merger moratorium -- an alternative, mind you, that makes painless the collective medicine that must be taken.

Admittedly, his legislative initiative would be politically expedient except that it indirectly offers the alternative of yanking from under the entire economy -- consumer and business alike -- the longstanding deductibility of interest payments on borrowed debt in the name of preventing job layoffs and plant closings.

Would it not appear convenient in this election year for those in the Congress who have done little to promote real competitive responsibility on the part of America's capital, labor and management to now propose either

(1) that threatened American industry be prohibited from merging, and thus proceed with its headlong fall further from worldwide superiority in commerce and industry, or (2) simply to allow the companies to merge in the old way which dumps the waste of management, capital and labor in the form of unemployment squarely at the feet of workers? In my view, merging and dumping the overlapping employees upon the remaining smaller taxpaying base of society for assistance will surely lead to higher taxes and even less productivity and competitiveness. Likewise, pressure at the polls would mount significantly for government intervention and price controls and, yes, a more serious form of American socialism.

I am here today, Congressmen, because almost no one over the last 10 years has seen fit, especially my self-serving Senator from Louisiana, to acknowledge or promote the utilization of the painless alternative of utilizing and conglomerating third sector, non-profit industry. Yet, Senator Johnston's legislation would, and in its own way has, prohibited Project 76 - An American Affair, Inc. ("The 76 Project")* from doing so at this critical time. The proposed legislation and its dangling threat to continued interest deductibility, in fact, prohibits The 76 Project (a public charity) from acquiring many companies among America's threatened industrial sector, specifically certain U.S. oil and gas distribution, processing and retailing assets, on terms favorable to management, capital and labor.

For example, when the news broke of Senator Johnston's proposed prohibitive moratorium on oil and gas mergers, including the unspoken suggestion of ending the deductibility of interest payments for business borrowers, I was actively involved in friendly discussions with Salomon Brothers to acquire the Gulf Oil Corporation, with Texaco's management to acquire many of the oil and other assets of Texaco, and later, the Superior Oil Corporation. I ultimately had to abandon these talks, which were already going slowly because of the non-profit nature of the transaction and the uniqueness of a tax exempt proposal that meant buying out the stockholders, taking the purchased companies private non-profit, and then merging them and operating them subsequently solely in the general public interest as defined by official government action at the federal, state and local level.

The question of continued interest deductibility brought to light by the Senator's initiative on top of the proposed acquisitions' already established uniqueness of approach, queered and ultimately caused me to discontinue friendly talks. After I undertook to outbid Socal for Gulf, buy the combined Texaco and Getty oil operations, and subsequently outbid Mobil for Superior, the uncertainty of future exploration and production opportunities available to merged companies put an uncertain chill on capital sources that would otherwise have been leaping to finance even The 76 Project's hostile acquisition of the properties in question.

Gentlemen, as Chief Executive Officer and Spokesman for The 76 Project, I can tell you that I have been waiting for some 10 years for the reality of, in many cases, subsidized foreign competition to force American industry to consider and undertake this simple but extremely effective new industrial ownership approach for threatened sectors.

For example, I made an effort to acquire the Getty Oil Company from Mr. J. Paul Getty in 1975 (documentation attached and submitted for the record).

But at that time the bud on the rose of the energy industry was simply too encouraging for anyone to sell out at a reasonable price. Now, on the other hand, that the bubble has finally burst, most oil companies will either merge like steel and electronics manufacturing and distribution, etc., be bought out by government or go simply bust with stockholders and the economy losing heavily.

Avoiding this catastrophe is why The 76 Project and I stepped in to utilize the new alternative, buy these companies, take them private, non-profit and operate them in the public interest.

Note should be taken at this point that as a condition of the various purchases, The 76 Project has obligated itself to retain and actively utilize in the public interest all overlapping employees who now as a direct result of the Senator's proposed moratorium will be fired by the merged companies with many of their previous work sites permanently closed. Instead of the Congress idly standing by encouraging this old approach, it should perceive and utilize the new recommended course of action.

Can it not be argued that Congress should in fact encourage The 76 Project to proceed with its acquisition in oil and other threatened industrial sectors in a manner that does not displace workers or continuously reduce product and service competitivesness.

To do so, the Congress would simply have to find such non-profit acquisitions in the public interest by resolution. No other legislative action would be required. Such a resolution by the Congress would immediately put a halt to the old-style acquisitions by these companies, for whatever reason, financed with borrowed funds. Upon facing this new reality, all capital markets would be flush with lendable funds and real interest rates would be forced to drop noticeably. Utilizing this new approach would consequently reduce long-term deficits at a rapid pace, hand-in-hand with increased services provided in the public interest outside the government appropriations process. Every sector of society -- capital, management and labor -- would as a direct result benefit.

To add real teeth to the resolution, the Congress should put on its agenda a Constitutional amendment that provides that "except in emergencies to be determined by a simple majority, where the private non-profit funding and administration of federal programs designed to achieve educational, economic, foreign aid, social or efficiency benefits in the public interest is not available, the deficit expenditure and/or federal budget appropriation of tax revenues by the Congress of the United States for such purposes is prohibited...." These services, on a competitive basis, would then be financed and administered by the private third non-profit sector.

We all know what would happen then. The size of government would decline at a rapid pace while the productivity of public servants shifted (not fired) to the private third non-profit sector would dramatically increase. We can all speculate that in the private sector, the quality and quantity of available public works, service, social welfare, educational and foreign aid activities provided by these workers would then dramatically increase.

As we all know, there are generally two ways of reacting to a problem of this nature that must be faced in an election year -- the expedient way and the just way. Loss of competitiveness is but another simple problem with an equally simple solution. That solution does not, however, require only one third of the problem -- workers -- to suffer 100% of the cost of a half-hearted temporary solution through unemployment. In light of the availability of the new approach, would it not be unjust to cause mass firings of employees in the private and public sectors as are now occurring unnecessarily in the State of Louisiana and throughout America? Will this pain not fall squarely on all low level employees, especially black ones, allowing both capital and management to totally escape judgment? Is this not unamerican?

Cannot the Congress of the United States perceive that a valid option exists? Why, when the Congress could free the third non-profit sector by simple resolution, can it not launch the U.S. economy on short order toward regaining from all trading partners our industrial and manufacturing superiority. Should labor, through unemployment; taxpayers, through more taxes spread over fewer taxpayers; and consumers, through tariff-ridden higher purchase prices for goods, pay the unnecessary and totally unjustified dues of the whole industrial society. Can Congress not see the dramatic increases in productivity realized in America's per-man-hour job performance since the onset of this, to some, ongoing recession? Can it fail to see that workers have learned that the American consumer will spend where the highest quality and best price is, regardless of what foreign land is responsible? Americans are now taking considerably more pride in their job performance, but they cannot do it alone. Should not management, capital and government be made to feel their fair share of the true bite of competition?

I ask, is there consequently not a very real political threat to those identified as responsible for collectively placing the total burden of taking the medicine on the helpless worker and taxpayer. Management and capital, in and out of government, should no more be able to avoid mandated increases in productivity than labor and employees. I ask, has capital become too sheltered and too lazy.

Nothing less than the future of the society is at stake. Should not the Congress utilize the painless new approach outlined herein while simultaneously freeing the economy, stopping taxes, and ushering in a wave of prosperity and unspent creativity throughout America. After all, should Congress be in the bed of the American economy when it is already wed by the Constitution of the United States to protecting its people from foreign and domestic brutality, economic and military?

Congress must perceive that we are well aware as civic-minded citizens and third non-profit sector businessmen that to simply catch our collective economic breath before we all drown, will simply not do!

SUTTON PLACE
GUILDFORD
SURREY
GU4 7QN

February 19th, 1976

Dear Mr. Cooper,

Your letter of recent date together with the enclosures adressed to Miss Janet Fox has been received in Mr. Getty's office. Mr. Getty wishes me to inform you that the Eastern Division of Getty Oil Company is not for sale. Also Mr. Getty's personal schedule is so heavy that he does not feel he has the time to participate in your other undertakings. Mr. Getty wishes you all the success in this respect.

Yours sincerely,

Norris Bramlett
Norris Bramlett

Mr. L. Napoleon Cooper,
P.O. Box 1994,
University Station,
Cleveland,
Ohio 44106.

Senator **Warner**. Thank you, Mr. Cooper. You are, of course, at liberty to make such additions as you desire.

Mr. **Cooper**. Thank you.

Senator **Warner**. Gentlemen, I thank you for your valuable contributions to the work.

The Chair is doing its best to accommodate all witnesses and their respective needs and I think it is in fairness that we have as our next panel Joseph Story, senior economist, Middle East Economic Service, Wharton Econometric Forecasting Associates, and Mr. Jack Blum, Independent Gasoline Marketers Council.

Mr. Blum, will you lead off?

STATEMENT OF JACK A. BLUM, GENERAL COUNSEL, INDEPENDENT GASOLINE MARKETERS COUNCIL

Mr. **Blum**. Thank you, Mr. Chairman, for giving me the opportunity to appear. I represent the Independent Gasoline Marketers Council, a trade association of nonbranded independent retailers of gasoline.

The Independent Gasoline Marketers Council is deeply concerned, for the same reasons Mr. Kirschner is, about the recent wave of mergers, and indeed we have made representation and significant representation to the Federal Trade Commission in an effort to get action to prevent those mergers.

I have a prepared statement and I ask that that be made a part of the record. What I would like to do is share with you some of my own experiences in this field. I did work for the Senate for some 11 years in this area. One of the most striking things is that this has all come full cycle. You might know that in approximately 1967, Senator Wayne Morse who was then chairman of the Senate Small Business Committee, held Senate hearings in which he had Don Turner, then the head of the antitrust division, I believe in Lyndon Johnson's administration, in front of him, and he was yelling at him for permitting a series of oil company mergers. Don Turner sat at the table and said that economic efficiency would really be assisted because there was overcapacity in the industry. And Senator Morse said, but that is not in the statute; there is nothing in the statute that says economic efficiency is a defense.

And Turner said that, no, there is overcapacity and I have prosecutorial discretion, and he chose not to prosecute.

The issue of economic efficiency from the prospective of the industry is a simple one. You can run a refinery at a 100 percent of capacity and charge what you like and you have an efficient company. If there is spare capacity, in the judgment of the operator, even if you are making money, it is inefficient.

The industry got so efficient as a result of those mergers and other reductions in capacity by 1972 the Congress was beginning to understand there was not enough gasoline and fuel oil to go around and by 1973, we had gasoline lines and a national crisis. Congress spent the next 8 years figuring out how to subsidize these people so that we could get enough capacity to refine enough gasoline to make enough crude oil and indeed even voting a $80 billion synfuels program, I am sure you have some recollection of that.

Now, the question is, Why does Congress jump in in the middle of each of the industry's business cycles, because it is a boom-and-bust standard business cycle that every industry has, describe it as a national interest situation and then make the business cycle worse?

That is exactly what Congress has done. By encouraging the overlooking of the antitrust laws now, what I predict is that all of these fellows who told you we have enough spare capacity to last into the next century are going to be as wrong in their predictions of that as they were 5 years ago when they told you that they could not build enough refining capacity to solve America's problems, even if you gave them the whole damn treasure.

I think that some thought is required before listening to those arguments about where demand will go and what is economic efficiency in this industry. A word has to be said too about the process by which Government is approaching this issue of how the industry ought to be restructured. The railroad industry, when two railroads want to merge, the Interstate Commerce Commission spends anywhere from 1 to 3 years figuring out what the impact on the public of the merger is and what ought to be allowed and what should not be.

The Federal Trade Commission is busily carving up by goverment fiat an industry which is at least as important as the railroad industry in a period of some 15 days allowed to it under the Hart-Scott-Rodino Act. It sits and tries to cure a merger that is on its face illegal by ordering divestiture here, some divestiture there and then we all wake up the morning after and wonder whether it makes any sense or whether the pieces that are being spun off will be viable.

We're now in the incredible situation of having three mergers backed into a Federal agency and these are the largest mergers, among the largest mergers in American history, which this agency is trying to solve in a period of a couple of months with no outside help, using purely antitrust theory, and no real consideration about what will happen when these different pieces are put out for buyers.

Perhaps Mr. Cooper will be the only live buyer for some of the properties ordered divested. Because there is no market for six refineries or seven refineries which are going to be coming up as a result of FTC divestiture.

This divestiture of refineries is a unique problem that this committee should be concerned about. Take for example, in the Texaco/Getty merger, the FTC said divest the El Dorado, KS, refinery. That refinery had to be divested because there was a pipeline problem and competitive problems in the Denver market. The FTC assumed that that refinery would be a viable entity, even though most people in the industry do not believe there will be a buyer for it, and they said you can be sure it is going to be viable because it is connected to all of these pipelines, which are also going to be divested. And some of the pipelines are pipelines to the Gulf coast, in particular the Texoma crude oil pipeline.

Last week, while the consent decree was pending the Texoma pipeline was sold to Houston Natural Gas without the pumping station for conversion to a natural gas line. What happened is the divestiture which 3 weeks ago might arguably have been viable has been made that much less viable and we are still in the process.

But now comes, I think, the punch line as far as the committee is concerned. The midcontinent refineries have been disconnected from the strategic petroleum reserves and the refineries that are there have been disconnected from their own crude reserves. The question of how this country will manage in a crisis and whether or not we are going to have a free market capable of distributing the strategic reserve from the gulf coast is an issue which has been considered by no one.

I submit when the next crisis comes, as it will, as this industry successfully becomes efficient again, questions will be asked as to why in the process of industry restructuring nobody wanted to know what was going to happen to the strategic reserve, which refiners were going to get it and which pipelines it was to be connected to.

Our concern is that this is a very bad way to run a government. The fact is government is deeply involved in these decisions. The FTC has acted as regulatory agency. It has acted very swiftly on a minimum of information. The Congress has not really studied the issue carefully and I believe the consequences, both competitive and in terms of national security and security of long-term supply, will be dire.

I really urge you to go back in and have a look at some of these consequences. Now, I could go back to the parochial concerns of the members of my association and they are parochial. They come down to will there be competing refiners who will give us product at low price? The nonparochial side of that is every penny on a gallon of gasoline is a billion dollars a year out of the U.S. economy.

And if we are not there to be the cutting edge competitively, there are going to be quite a few billion dollars that come out of the economy with no net benefit to society as a whole. I can appreciate the arbitrageur's interest and I can appreciate Mr. Pickens's interest, but in the end, the national security and the consumer will not be served, if those interests are served.

If you have any questions, I will be glad to try to answer them.

[The prepared statement of Mr. Blum follows:]

BEFORE THE

SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

ON BEHALF OF

Independent Gasoline Marketers Council
1015 Eighteenth Street, N.W.
Washington, D.C. 20036

Submitted by:

Jack A. Blum
Blum, Nash & Railsback
1015 Eighteenth Street, N.W.
Washington, D.C. 20036

April 10, 1984

My name is Jack A. Blum. I am the General Counsel of the Independent Gasoline Marketers Council, a trade association of nonbranded independent retailers of motor gasoline.

The recent wave of mergers among major oil companies is a matter of deep concern to the members of the Council because the mergers have reduced the number of suppliers of gasoline at the refinery gate and will undoubtedly reduce the willingness of the remaining firms to cut their prices to customers. Inasmuch as Council members shop the refining community for the lowest possible price and compete by keeping low prices on the street, the reason for our concern should be apparant.

Of course, we would like you to address our pariochial concern, but we think that there are larger national issues which demand congressional attention.

The petroleum industry is cyclical. It goes through periods of boom and periods of bust. Normally the cyclical problems of a particular industry are of little of no concern to Congress, but the petroleum industry is so large that its boom and bust cycle has a major impact on the national economy, on our foriegn policy and on our national security and this is a proper matter for government to consider.

I remember being at an American Petroleum Institute convention in the late 70's and hearing an oil company executive remark that he couldn't understand why good times in the oil industry mean the country is going to hell and bad times for the industry mean good times for the rest of the country. The answer to his question lies in the fact that energy prices are inelastic over the short term. A sudden jump in oil prices leads to skyrocketing inflation as the costs are passed through to the end consumer.

It also means the diversion of vast amounts of capital from other sectors of the economy as the oil industry responds to increased prices by investing more in exploration and development. The impact of higher oil prices on foreign trade, the banking system, and the balance of payments are all still fresh memories.

In the period of overcapacity, the petroleum industry has to face the danger that prices will fall to the marginal cost of production of the incremental barrel, and perhaps lower. Just as inelasticity works to push prices through the roof in a shortage, it works to push prices down in periods of oversupply.

The enormous impact of price swings in the industry has led to almost continuous government intervention to assure supply through subsidy and to some degree "protect" consumers through price controls.

In periods of relative glut it has led to government intervention to stablize markets such as the "Hot Oil Act", the oil import quota system and a wink and a nod from antitrust enforcement agencies at industry practices which stabilize prices ranging from approving otherwise illegal international joint ventures for "national security" reasons, to non-competitive transporation arrangement such as the TAPS pipeline and, of course, the recent mega-mergers.

Government's role has been reactive and in each case, oversupply and shortage alike, government has tended to make the impact of the cycle worse. For example, in the supply crisis of the late 70's the Department of Energy encouraged the construction of new refining capacity, refining upgrading, tertiary recovery and synthetic fuels programs which created much of today's overcapacity problem. The success of those programs are a substantial cause of today's overcapacity.

On the other hand, when Lyndon Johnson and Don Turner, the then head of the Antitrust Division, winked at the merger wave of the late 60's and allowed combination after combination, and when the Nixon administration authorized joint negotiations with Middle East governments under a business review letter, the stage was set for the supply crisis of the early 70's.

The question is when will Congress learn? How many times must we go through these boom and bust cycles before Congress says enough and adopts long-range policies aimed at to preventing recurring disasters.

In the late 1960's Senator Wayne Morse, then Chairman of the Senate Small Business Committee called Don Turner and asked him to explain why the Antitrust Division had not acted to block what had then become a series of six large petroleum industry mergers. Turner's response was that the mergers were necessary to improve the economic efficiency of the oil industry, that there was domestic overcapacity and that that capacity was being operated inefficiently. Senator Morse thundered at him that the antitrust laws made no reference to economic efficiency and as a prosecutor he had no right to put it into the law.

Turner's answer was that it was within his discretion not to prosecute and he believed that economic efficiency was part of what he had to consider in making his prosecutorial decision.

Needless to say, within the short space of three years, the country moved from glut to shortage and the industry was so "efficient" that gasoline lines became a feature of American life.

The underlying point is that economic efficiency from the point of view of the producer is the operation of a plant at 100% capacity. 100% utilization of plant and equipment produces low unit costs and high profits. It does not produce the spare capacity which society needs to protect against shutdowns, accidents and sudden surges in demand. It also deprives society of the benefits of price competition.

We believe that where two parties to a merger which are both significant factors in the same industry and are both making money even though their facilities are operating at less than capacity, the natioanl interest requires that these competing entities be prevented from merging.

A few words need to be said about the lack of energy policy input in the governmental review of the pending mergers.

Antitrust laws address antitrust concerns. The Federal Trade Commission in doing its one day review of the mergers has focused on areas of refining and marketing overlap and in the Texaco-Getty case worked out a consent decree to take care of those problems. The result, despite wonderful language in the consent order will be a group of orphaned properties of questionable viability.

To cite but one of the energy policy issues, mid-continent refiners have been able to count on an open market for crude oil at the Cushing, Oklahoma terminal. Two major crude oil pipelines from the Gulf Coast, Seaway and Texoma, supplemented the lines from West Texas and guaranteed that the Cushing price would never rise above world market levels. Further, the two pipelines tied mid-continent refining capacity to the strategic petroleum reserve.

Last year, Seaway became a natural gas line.

The Texaco-Getty consent order assumed the continuation of the Cushing market for crude in its provisions regarding the spin off of the Getty El Dorado, Kansas refinery.

Wintin the last week, the remaining crude line, Texoma, was sold without its pumping stations and will be converted to a gas line.

This sale makes the prospect of successful divestiture of the El Dorado refinery remote and raises the energy policy issue of how the strategic reserve will be utilized and what happens to the mid continent as local reserves decline in the event of a serious crisis.

Make no mistake about it, the consent decree process is a government restructuring of industry under awesome time pressure without opportunity for the affected public, the Congress or the Department of Energy to participate to be certain the results are rational from a national security and energy policy point of view.

The important issue in these mergers is control of crude oil, not as the FTC has said, marketing overlap. Entry and exit at the retail station level is easy if you can find a reliable, price competitive supply of product. The reliable, price competitive sources have been the firms with crude reserves. These firms are now being stripped of what makes them reliable and price competitive, namely the crude, and the resulting pieces will not help keep the competitive situation alive.

When railroad mergers are proposed, the government goes to great lengths to study the issues and get public comment before approving the transaction. In the last ten years, we have been taught that energy supplies are at least as important as railroads which should force the conclusion that serious study of energy mergers is in order and that the time periods in the Hart-Scott-Rodino bill are altogether inadequate to the task.

Thank you for giving me the opportunity to testify. If you have any qeustions, I will try to answer them.

Senator WARNER. That is an important statement for this record. I hope that you now feel that through these series of hearings that Congress has now had an opportunity to—the adequacy remains to be seen, but has had an opportunity to devote much needed study to this.

Mr. BLUM. I hope that study will produce a result. Remember the restructuring is in process. It is a moving ball game. If the result of the study does not begin to show up in the form of legislation or direction back to regulatory agencies and administrative agencies before this particular restructuring is over, it may be the next energy crisis and the aftermath which will be the one that Congress will be coming to grips with.

I think that some of the issues here are very profound ones for the country and if it had not cost us so many billions of dollars in the last crisis and caused so much grief for everyone concerned, you might say, well, we can wait and come up with a legislative solution after this round is over. But I don't think anyone wants to go through that.

Senator WARNER. We recognize this morning you were not able to participate in the panel, because you were otherwise engaged in the other service.

Mr. STORY. Yes, indeed.

Senator WARNER. Would you prefer your testimony appear on the other panel or are you satisfied with it appearing here?

Mr. STORY. I am perfectly satisfied wherever it appears. I had, in fact, worked with him over a number of years and he was, as you know a member of this committee.

Senator WARNER. Thank you. The Chair did not know whether to go ahead or not. I am certain he would have suggested we go ahead.

Mr. STORY.

STATEMENT OF JOSEPH C. STORY, SENIOR ECONOMIST, MIDDLE EAST ECONOMIC SERVICES, WHARTON ECONOMETRIC FORECASTING ASSOCIATES

Mr. STORY. Thank you, Mr. Chairman. You missed me this morning; I was to be on the panel with Henry Schuler and John Lichtblau, and that explains why I would like to address some of the possible international implications of the recent U.S. oil merger activity.

Let me start off by saying, I do not believe there are any very direct connections between the international oil market and the recent state of U.S. mergers. However, there are indirect connections and I believe this activity is systematic of some larger problems we may be facing in the international energy picture in the future, not too far down the road.

Two areas I would like to go into that have some bearing on the international side. The first is what Mr. Blum has been talking about in general, the restructuring of the industry rather than why some of this merger activity has occurred. In the 1970's, of course, with a period of internationally rising prices for energy and oil and with growing demand over most of the last decade, we stopped the proliferation of oil companies in the United States and around the world.

It was a good business to be in. And since our international oil glut started some 4 years ago, we have seen just the reverse. So to a certain extent, this is just a normal shaking out of the United States and the international oil industry.

As we go about this shake out, you will find that the remaining large companies are probably going to be streamlined. In some instances, you will probably have economies of scale from the new company. In some areas we cannot be sure. For instance, you will find two large companies merging. In their planning and economics department, one might supersede the other and it just may happen that the good planning department loses its job. I have seen this happen in at least one merger over the last few years.

But the international importance is probably that in order to repay debt in the coming years, the oil companies, the new companies are going to be selling off bits and pieces and parts of the existing company after the merger. We see this happening now, but it is going to be a continuing process, I believe, and the question is who is going to buy these bits and pieces, refineries, marketing outlets, et cetera?

I see one answer to that question being foreign companies that have the money. This could be some European companies, but I think more pertinent might be a new phenomena and that is the expansion downstream of some of the OPEC oil companies, especially in the Middle East. The leading candidate probably is Kuwait Petroleum Corp.

As you probably know, they have bought several hundred service stations from Gulf in northern Europe this past summer and fall and refineries in England. And just recently the chairman of Kuwait Petroleum Corp. announced that his company was planning to also expand downstream in Asia.

Two other national oil companies in the Middle East, the Petromen in Saudi Arabia or what is going to be some day the Saudi National Oil Co. is a candidate for purchases downstream, including the United States. Suzaka Omini mentioned about 3 months ago that this was an intention for the future oil policy kingdom, not necessarily in the United States, but downstream.

A third candidate is United Arab Emirates who have in place now the corporate structure that would be able to do that. They have just done this in the last year. In the case of these three countries in the Middle East, the important part is that they have the cash.

The Gulf Cooperation Council, which is made up of Saudi Arabia, Kuwait, United Arab Emirates, Oman—there are six of them, anyway, their invested assets as well as their reserved assets invested abroad currently amount to about $265 billion. Some of this cannot be touched easily, but much of it is also invested in terribly liquid funds, including treasury bonds, bills, et cetera.

My point here is this is going to be going on in the next few years, I think some of these bits and pieces being divested or being sold off by American companies will probably come up for sale and probably be bought by some of these Middle Eastern countries. I think it would be a good idea as soon as possible for the Congress to look into what this means for U.S. public policy, for good or for bad.

The second point I wanted to refer to was the question of reserves, U.S. reserves. Most of the people that appeared before your committee agreed that a major reason for these mergers has been to obtain reserves of other companies in the United States. To give you an idea of how the situation has changed in the United States in the oil industry over the past decade, I will take the example of Exxon, since they do not have any representative here today, I do not think anyone will be able to contradict me. In the case of Exxon, in 1973 10 years ago, the Exxon Corp. had access to about 38 billion barrels of oil.

This oil was about 75 percent—no, it was about 75 percent OPEC countries, I believe at that time. Today, they have 6.5 billion barrels of reserves, mostly in the United States. So that dropped from 38 billion 10 years ago to 6.5 today. Similarly, in their access to crude oil supplies, 10 years ago in the early seventies it amounted to about 6 million barrels of oil a day. Today their access to oil worldwide is about 1.6 million barrels a day.

This is sort of an example of how the structure for U.S. oil companies has changed in terms of their access to oil. The main factor discussed before your committee, I think, today has been that it has been cheaper to buy U.S. reserves than drill for it. This is generally agreed upon.

The second factor which has not been discussed very much is that oil reserves located in the United States are safe oil reserves. In the world today, most people in the industry agree, that there are only two places where oil reserves are safe. That is the United States, including Alaska, and the North Sea, and most companies are willing to pay a premium to have access to this oil.

The rest of the world is considered, especially by the industry, to be a hostile environment to one extent, one to a greater extent or another, more or less.

Senator **Warner**. Hostile being political or weatherwise or——

Mr. **Story**. Exactly. I was going to say it is difficult to drill oil in most of these new areas that have not been explored before in Asia, Africa; it is politically unstable, especially in the Middle East where the reserves of the world are located. There is a great desire to have safe reserves. To have reserves in unsafe areas is to create political, economical, transportation, and technological problems for your company that you do not need.

And it has gotten so bad in the Middle East where the reserves and the productive capacity and exports are available that there is a war going on.

This is one of the best examples of the reasons for wanting to be in the United States rather than abroad. My point in bringing this up, and emphasizing the safety of U.S. reserves, is this, I think, is an area that Congress may wish to examine and that is if the U.S. oil reserves are going down, production is going down—everyone agrees on this. Several oil companies have recently come out and said they expect U.S. production to decrease by 20 percent by 1990, so if U.S. reserves are going down in terms of national security for energy, that should mean the United States would prefer to bring their oil in from abroad and save their own reserves to the extent possible, rather than depleting their own reserves first and becoming in later years more dependent on foreign sources.

The second point I would like to make as a policy recommendation or suggest to the committee is for the committee to look into the possibile ways that the industry might be encouraged to explore abroad in this admittedly hostile environment whether it is taxation or whatever ways, taxation, et al., that might incline the companies to be more aggressive in exploring in Asia, Africa, and Europe, more so than they do now.

I am not suggesting that there is not an awful lot of U.S. oil company activity abroad now; I am just suggesting it might be better for national security in the future if we did more of it.

Thank you.

Senator **Warner**. Thank you very much. We value your contributions. I thank you all very much.

We will now have Mr. William Harmon, principal, general counsel, and secretary, Morgan Stanley & Co. Inc., and Dr. Thomas R. Robinson, senior vice president, Merrill Lynch Economics, Inc.

STATEMENT OF WILLIAM R. HARMON, GENERAL COUNSEL, MORGAN STANLEY & CO., INC., ACCOMPANIED BY SIMON P. ORME, PRINCIPAL, MERGERS DEPARTMENT; AND JOHN D. PAULUS, CHIEF ECONOMIST

Mr. **Harmon**. Good afternoon. My name is Bill Harmon and I am general counsel of Morgan Stanley & Co., Inc., a New York investment banking firm. With me today are Simon Orme, who is a principal in our mergers department and John Paulus, who is our firm's chief economist.

We appreciate the opportunity to appear before your subcommittee today to express our firm's views on oil company mergers. Mr. Orme will address the impact of mergers on oil company exploration activity from a financial point of view and Mr. Paulus will address the implication of oil mergers for the credit markets and interest rates. Morgan Stanley is a full-service investment banking firm, which is engaged in all phases of the capital markets.

We provide financial advice to a broad spectrum of corporate and institutional clients. We are a leading firm in mergers and acquisition activities and serve as a financial adviser to both acquirers and acquirees in merger transactions, including oil and gas mergers. We have participated in over 150 mergers over the last decade.

I should note at the outset that we are serving as a financial advisor to Standard Oil of California in its acquisition of Gulf Corp., and to Superior Oil in its acquisition by Mobil. On the basis of our general experience, we would like to offer several observations on oil company mergers and we will be happy to answer any questions after a short presentation. Mr. Orme.

Mr. **Orme**. Mr. Chairman, I would like to make just three fundamental points and then briefly elaborate on them. First of all, in our view, mergers of this scale do not adversely affect the level of exploration effort of major oil companies, and indeed there is some cause to believe that larger mergers of this kind encourage exploration.

Second, mergers do not significantly affect the capital resources available to major companies for exploration endeavors.

Third, any legislation to bar mergers is likely to discourage exploration activities. I believe that mergers can result in significant benefits to the economy through greater efficiency, economies of scale and transfers of technology. A good example of this which was referred to earlier today is the Shell Oil Co. acquisition of Belridge. In that case Shell's financial resources and production technology greatly enhanced the productivity of Belridge's heavy oil reserves.

In my opinion the stock market is rational and a well-conceived merger of this kind is likely in the long run to be reflected in the stock market through better stock market performance and higher returns to investors. The merger decision is unrelated to the exploration decision. We have had in earlier testimony today that there are basically four elements that impinge on the exploration decision, geology, technology, economics, and Government policy.

Speaking of the third of these, economics, exploration activity is undertaken by an oil company if the expected future cash in-flows, that is the results of future prices that the product can be sold at without lifting costs, taxes and so forth, represent a return on the initial exploration investment, which exceeds the investing company's cost of capital.

The cost of capital is not solely the cost of that company's debt. It is a composite of debt and equity costs. The major oil companies in contrast to the smaller independents do not rely as heavily on borrowing to drill. They rely upon a composite of financing sources, including the equity markets and their internal cash flow.

If well-conceived mergers in the long run do indeed result in better stock market performance, that would tend to lower the cost of equity components in the merged entity's cost of capital. And a lower cost of capital will result in increased exploration activity by lowering the rate of return that an exploration project must demonstrate to be pursued.

I believe, therefore, that mergers do not adversely affect the willingness of the merged entity to make exploration expenditures or the scale of those expenditures. Indeed, the preponderance of the evidence is the other way. In recent examples of the United States Steel acquisition of Marathon, DuPont's acquisition of Conoco and the Shell/Belridge, I have already referred to, all of these substantially increased their exploration development expenditures after the mergers.

Further, majors have never been capital constrained. Both Socal and Texaco will continue to have more than sufficient access to the capital markets to finance their ongoing exploration programs. Finance availability to these merged entities is not an issue.

My final point is that banning mergers may hurt exploration activities and this is the converse of the cost of capital argument that I just presented. By banning mergers amongst the major oil companies, common stock investors in these companies will lower their expectations of return, which may have an adverse effect on the stock market performance of these companies, and indeed the uncertainty introduced into the markets by recent congressional action in this area has caused its effect in part already.

A stock market performance that is adversely affected in this way will increase the cost of capital by increasing the cost of equity components and increase the hurdle rate for expiration investments, which may well fall as a result.

Thank you very much.

Senator **Warner**. Do you have any observations with respect to the question, Is there a credible causal relationship between this merger activity recently and the trend of rising interest rates?

Mr. **Orme**. I don't believe there is, sir, but my colleague, Mr. Paulus, our chief economist, intends to address that in his remarks.

Mr. **Paulus**. Mr. Chairman, I would like to comment briefly on the effects of merger financing on interest rates and even more briefly on why interest rates have been rising since they hit their lows last spring. There are two types of borrowing. That is that done to finance the purchase of real assets, such as for the construction of industrial plants, and there is that done to finance the purchase of financial assets such as treasury bills or corporate stock.

The first type of borrowing raises interest rates. The second type does not. To see why, consider what happens when one borrows to purchase a real asset. Again, let's assume it is for the construction of an industrial plant. The proceeds will be used to pay the workers who constructed the plant and the suppliers of the industrial materials that went into building the plant.

The workers and the suppliers in turn will treat these proceeds as income and will consume a large portion of those payments and save a relatively small portion. As a result, the increase in borrowing to build a plant will be only partially offset by an increase in the supply of funds coming from the workers and suppliers.

Consequently under those conditions, interest rates would rise. Now, if the situation is different, when one borrows to purchase a financial asset, then the proceeds go to a saver, to someone who has been holding but has given up a financial asset. Presumably that person will wish to reinvest the proceeds or to pay down debt.

If the proceeds are reinvested, the increase in the supply of credit would equal the increase in the initial demand for credit. There would be no effect in interest rates. If he wished to pay down debt, his reduction in debt would equal the increase in debt coming from the initial loan and there would be no net increase in the indebtedness in the economy.

More realistically, what we would expect is a portion would be used to pay down debt and a portion would be reinvested. The net effect on interest rates would be a total wash, aside from perhaps a small effect during a very brief period, which we would measure in days and not even in weeks.

Merger financing falls into the second category of borrowing, the one that has no effect on interest rates. That is to say the original holders of the stock of the acquired company likely would take the proceeds and invest them and also pay down debt.

According to the empirical work that I am aware of, at most only a very small part would likely be spent. Now, I therefore believe that merger financing has at most a negligible effect on interest rates, unless a family business is being acquired and there is a prodigal son involved and much of the proceeds are spent. But empirically, I do not think that case can be supported.

On the second matter of why interest rates have been rising, there are a whole lot of reasons and I could probably ramble on for a long time, but if I could point to one thing I think I would say because there has been a substantial rise in borrowing of the first type, that is to say the type which is used to purchase real assets.

Let me just quickly cite three examples, and there are more. Business-fixed investment spending, that is on real plant equipment, expanded at a record rate in real terms in 1983, that is a record rate for the first year of economic expansion. That has to be financed. Housing starts moved above 2 million last month and have been maintained at a relatively high level for several months, close to 2 million units.

As a consequence, mortgage borrowing by households has moved up close to a record level.

Third, Federal Government borrowing, which in the end is used to acquire real assets and real goods, has been of course proceeding at a rapid pace.

In short, I think interest rates have been rising because of the rapid pace of real economic activity in the United States, not because two parties are swapping one piece of paper for another piece of paper.

That concludes my remarks.

[The prepared statement of Mr. Harmon follows:]

STATEMENT OF
MORGAN STANLEY & CO.. INCORPORATED

BEFORE THE
SENATE ENERGY AND NATURAL RESOURCES COMMITTEE
SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
APRIL 10, 1984

1. Consolidation in the oil industry is being driven by economic forces, including excess capacity in downstream operations, reduced demand for oil, lower oil prices, and increased cost of finding and producing new reserves.

2. Mergers can result in significant benefits to the economy if certain efficiencies are gained, including economies of scale, marriage of complementary factors, rationalization of production facilities, replacement of weak management and economical transfer of technology.

3. The level of exploration and development expediture is determined by the economics of drilling for new reserves, such as drilling prospects, oil prices set by OPEC, costs of finding and producing new reserves and the tax structure of the industry.

4. Mergers do not divert funds from exploration activities to non-productive uses; mergers are capital transactions involving the change of ownership of corporate entities and are an efficient reallocation of assets into more productive hands.

5. Exploration activity is largely dependent upon oil prices and the data shows there is no inverse correlation between exploration and acquisition spending.

6. Acquisitions have not for the most part resulted in less exploration among merged oil companies; for example, the combined entities of US Steel/Marathon, DuPont/Conoco and Shell/Belridge have significantly increased their exploration and development spending over that of the separate entities.

7. The high cost of exploration and the consequent financial risks demand major financial commitments which can best be met by large well-capitalized oil companies.

8. The financing of acquisitions by large amounts of debt will not result in lessening of a well-run major oil company's commitment to exploration; exploration expenditure and funding are fundamentally separate from acquisition decisions and each is decided on its independent merits.

9. The higher debt to equity ratio resulting from acquisition borrowing and the probable reduction in credit rating will not hinder a well-capitalized major's access to the credit markets even after an acquisition; SOCAL, for example, will be in better financial shape than a large number of financially pressed independents and will be able to fund its ongoing exploration and production plans.

10. The imposition of artificial restrictions on mergers among the top 50 oil companies will result in lower equity prices because of investor perception of lower investment returns which in trun will be translated into higher cost of capital for large oil companies and a greater inability to make needed financial commitment to exploration.

11. There is more than sufficient capital available in the U.S. capital markets to fund new exploration activity by others if the basic economics of exploration should become more favorable. Artificial government intervention into the efficient capital allocation process may adversely impact the ability to attract new capital.

STATEMENT OF DR. THOMAS R. ROBINSON, SENIOR VICE PRESIDENT, MERRILL LYNCH ECONOMICS

Dr. **Robinson**. My name is Tom Robinson and I am senior vice president and manager of domestic and international business economics for Merrill Lynch Economics in New York. Given the fact that I am the last witness today, I should be mercifully brief.

Senator **Warner**. The contributions by this panel are significantly important for the question before the subcommittee. Take your time.

Dr. **Robinson**. Thank you very much. Essentially, I plan to address two topics, one, to reiterate some of the points that Mr. Paulus has made, the money and capital market aspects of mergers and acquisitions and the broad issue of shareholders' interests involved in this whole question.

The marketplace essentially allocates funds to those with expected cash flows to service and repay borrowed funds or to pay reasonable dividends to assure market price appreciation through performance on an equity investment. Businesses with those capabilities have superior rates of return and so obtain funds more easily and more cheaply than those which are less profitable.

Credit used to acquire existing capital is an essential part of this process. It is, however, a financial transaction, identical to the purchase and sale of common stocks, Government securities, and other debentures.

It is impossible to sort out for any given transaction in the marketplace whether the borrowing is a new addition to the stock of credit, but in the aggregate we can identify ex post the amount that is new money. The basic point is that the money flows through the market from owner to owner many times in financing the transfer of financial assets, but in the process it does not preclude the financing of new capital structures and equipment or other types of capital by those who sell new stocks, notes and bonds into this huge fluid market.

The bottom line is that borrowing in the financial markets does not increase interest rates and even if expectations or circumstances were such that participants in the market believed it would, the resulting rate rise would be very small and very brief.

An acquisition of an existing asset is not critical in the interest rate aspect of the equation because again it is purely a financial transaction. Cash, which is a financial asset is exchanged for another type of financial asset, one that represents ownership of existing capital. The cash proceeds are then plowed back into the market and no more than temporary difficulties could develop in such a situation.

The fungibility of money assures that the proceeds from the purchase would flow back into the money or capital markets where they would be available to finance business or other credit needs. No credit is withheld from other borrowers and the effects on interest rates, if any, are very small and shortlived and would arise only from the illusory expectations of market participants.

Furthermore, some part of the proceeds received by shareholders is paid in taxes, thereby offsetting the need for an equivalent amount of borrowing by the Federal Government.

The issue of the absolute size of a credit line is sometimes raised in terms of its overall financial market impact. This is not a valid issue, however. No single transaction is large enough in absolute terms to dominate the total market that last year in gross equity transactions amounted to $30 trillion and in gross bank lending investments of more than $4 trillion.

Moreover, a transaction must also be placed in the context of the amount of net new credit which last year amounted to $510 billion and this year is targeted by the Federal reserve in its expansion of nonfinancial credit at $470 to $570 billion. So placed in this context, I think it is indeed a very small amount.

Senator **WARNER**. You are getting into figures like Congress now.

Dr. **ROBINSON**. It is particularly fitting that we talk about it in the Dirksen Office Building.

In short, I believe that a lot of the discussion of the interest rate impact diverts attention from the basic underlying causes of interest rate pressures. As Mr. Paulus suggested, those interest rate pressures have arisen because we are in a growing economy. We do still have a high Federal budget deficit, but we do have a chronically low saving domestic economy and we are highly dependent upon foreign capital in-flows. This is the equation that was used in rising interest rates and it has been anticipated, I think, that this would occur as the recovery matures in any event for some time.

Now, I would like to turn briefly, if I might, to the broader shareholders' interests in mergers. Stockholders, as equity owners in an enterprise, typically expect that the management of the assets of the companies in which they invest will actively seek to earn the maximum return on their market investments. Those assets include the purchase or sale of existing assets to achieve the best performance for the investment dollar.

If the transactions are freely entered into either by the managements of the two firms on behalf of their shareholders or if one firm purchases shares in the open market from investors at a price mutually agreed upon, there is a reasonable presumption that the return objectives of the market investors in the acquiring firm as well as of those selling the shares have been met.

The offer often represents a significant price premium over the price of the common stock of the acquired firm, and the stock price of the acquiring firm is rarely depressed more than marginally. It should not be if the merger is expected to be profitable.

A final and basic point. Investors are accustomed to assessing various types of risks, including those posed by existing and proposed regulation, in order to determine the attractiveness of alternative investment opportunities. These assessments clearly extend to usual antitrust matters.

Investors would, however, be reluctant to commit their resources if they had reason to believe that the Government could make major changes in the investment ground rules, in any area and virtually at will, and by so doing, impair their original investment. Legislation that has a retroactive aspect by substantially expanding the role of Government in the merger process would add a new element of risk and could only impact negatively equity valuations and impair stockholder confidence in the integrity of the securities markets.

In short, legislation dealing with merger matters must be weighed, in my judgment, very carefully because its impact extends beyond any single or group of deals or beyond the impact on any one or group of shareholders. It goes right to the foundation of the contractual basis of our free and vibrant financial system. Legislation that impairs the efficient working of that system, which is the envy of the world in its capabilities of the mobilization of savings, adversely impacts one of our most valuable national resources. The public interest, I do not believe, would be served by such an action.

Thank you.

[The prepared statement of Dr. Robinson follows:]

PREPARED COMMENTS
DR. THOMAS R. ROBINSON
SENIOR VICE PRESIDENT
MERRILL LYNCH ECONOMICS

APRIL 10, 1984

My name is Tom Robinson, and I am Senior Vice President and Manager of Domestic and International Business Economics for Merrill Lynch Economics in New York. I plan to address two topics: The financial market aspects of mergers and acquisitions and then the broad issue of shareholders' interests.

Basic Principles of the Financial Aspects of Mergers

The marketplace allocates funds to those with the expected cash flows to service and repay borrowed funds or to pay reasonable dividends or assure market price appreciation through performance on an equity investment. Businesses with those capabilities have superior rates of return and so obtain funds more easily and more cheaply than those which are less profitable. Credit used to acquire existing capital is an essential part of this process. It is a financial transaction, identical to the purchase and sale of common stocks, government securities and other debentures. Money flows through the market from owner to owner many times in financing the transfer of financial assets, but in the process, it does not preclude the financing of new capital structures and equipment or other types of capital by those who sell new stocks, notes and bonds into this huge fluid market.

The bottom line is that borrowing for mergers and acquisitions in the financial markets, even in the amount of $13.2 billion by Standard Oil from more than 60 commercial banks to purchase Gulf Oil, does not increase interest rates and, even if expectations or circumstances were such that participants in the market believed it would, the resulting rate rise would be very small and very brief.

Let me go into this point on interest rates in a little more detail. Interest rates--the price for credit--rise or fall in response to changes in supply and demand. Total demand in the private sector is determined by the income expectations (including inflation) of borrowers and households as well as businesses. The supply of credit is partly determined by monetary policy, but only partly and often a small part at that. Over the short run, the total amount of credit supplied by lenders depends upon a variety of factors, the most important of which is the volume of saving, and these savings flows are typically much more important than monetary policy in terms of total new funds availability. For example, in 1983 the net increase in outstanding credit, as measured by the Federal Reserve, was 29% larger than in 1982, far in excess of the growth in money supply alone.

Credit that is used to build new real assets--producers' equipment, manufacturing plants and inventories--can and often does intensify pressures on the economy, pushing it against capacity ceilings. When that happens, the bidding for resources is reflected not only in higher interest rates as credit demands rise but also in the prices for commodities and other real assets. We appear to be some distance from that point at this time. However, an acquisition of an existing asset is not critical in the interest rate aspect of the equation because it is purely a financial transaction--cash, a financial asset, is exchanged for another kind of financial asset--one that represents ownership of existing capital. The cash proceeds are then typically plowed back into the markets. No more than temporary difficulties could develop in the such a situation.

The borrowing does not withhold credit from competing borrowers. It is a financial transaction in which shareholders receive cash in exchange for their equity shares, which is analytically equivalent to an ordinary equity market transaction where shareholders buy and sell shares in U.S. corporations. The merger transaction is different only in that it involves the purchase of all the shares of a single company.

The issue of the absolute size of a credit line is sometimes raised in terms of its overall financial market impact. This is not a valid issue, however. No single transaction is large enough in absolute terms to dominate a total market that last year in gross equity transactions amounted to $30 trillion and in gross bank lending and investing to more than $4 trillion. Moreover, a transaction must also be placed in the context of the amount of net new credit, which last year amounted to $510 billion, and this year is targeted by the Fed at $470-$570 billion.

Of course, as noted before, borrowing for merger and acquisiton purposes is not a net addition to total outstanding credit, as might be the case if the borrowed money were used to acquire real new capital, whether it be brick and mortar, machinery, new automobiles and houses, or educational capital for our children. Instead, it is a purely financial transaction in which the borrowed money would pass swiftly to the shareholders. However, they would then use those proceeds to buy other stocks or bonds or deposit funds in one of a hundred accounts at their local banks, brokerage companies, or other providers of financial services. The fungibility of money assures that the proceeds from a purchase would flow back into the money or capital markets where they would be available to finance business or other credit needs. No credit is withheld from other borrowers, and the effects on interest rates, if any, are very small and shortlived and would arise only from the illusory expectations of market participants. Furthermore, some part of the proceeds received by shareholders is paid in taxes, thereby offsetting the need for an equivalent amount of borrowing by the federal goverment.

Broader Shareholders' Interests in Mergers

Stockholders, as equity owners in an enterprise, typically expect that the management of the assets of the companies in which they invest will actively seek to earn the maximum return on their market investments. The management of those assets includes the purchase or sale of existing assets so as to achieve the best performance for the investment dollar. If the transactions are freely entered into either by the managements of the two firms on behalf of their shareholders or if one firm purchases shares in the open market from investors at a price mutually agreed upon, there is a reasonable presumption that the return objectives of the market investors in the acquiring firm as well as of those selling the shares have been met. The offer often represents a significant price premium over the price of the common stock of the acquired firm, and the stock price of the acquiring firm is rarely depressed more than marginally. It should not be if the merger is expected to be profitable.

Conclusion

A final and basic point. Investors are accustomed to assessing various types of risks, including those posed by existing and proposed regulation, in order to determine the attractiveness of alternative investment opportunities. These assessments clearly extend to usual anti-trust matters. Investors would, however, be reluctant to commit their resources if they had reason to believe that the government could make major changes in the investment ground rules, in any area and virtually at will, and by so doing, impair their original investment. Legislation that has a retroactive aspect by substantially expanding the role of government in the merger process would add a new element of risk and could only impact negatively equity valuations and impair stockholder confidence in the integrity of the securities markets.

In short, legislation dealing with merger matters must be weighed very carefully because its impact extends beyond any single or group of deals or beyond the impact on any one or group of shareholders. It goes right to the foundation of the contractual basis of our free and vibrant financial system. Legislation that impairs the efficient working of that system, the envy of the world in its capabilities at mobilizing savings, adversely impacts one of our most valuable national resources. The public interest would not be served by such actions.

Thank you.

Senator WARNER. That is very clear and succinct testimony and quite a valuable addition to the record and I thank you. I will make certain that those observations you provided today are contained in this committee record in response to the resolution now before the Senate.

I express to you my personal appreciation for your patience. Usually this committee, under the chairmanship of Senator McClure, operates in an efficient and timely manner. This has been an unusual day for a variety of reasons.

I apologize to you for the personal inconvenience to you and other witnesses and attendees. I thank all of you for your participation. Thank you.

The record of this subcommittee hearing will remain open for 3 weeks.

[Whereupon, at 4 p.m., the hearing was adjourned.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

SUBMITTED BY THE DEPARTMENT OF THE INTERIOR

Why do mergers happen?

The current merger activity in the oil industry should be viewed as a response to natural market forces. It reflects decisions by those with business judgment and industry expertise far superior to that that can be mustered by Government policymakers. Mergers are often the most efficient means of matching complementary assets. For example, a company with expertise in production might seek to acquire a company with proven reserves but less efficient production facilities. In addition, the possibility of a takeover puts pressure on corporate management to be vigorous, cost-conscious, and innovative to the benefit of oil consumers, stockholders, and the general public.

One of the major reasons for the current round of mergers is the fact that the book value of the stock of several oil companies is well above the market value. This means that the liquidated net value of the assets of these corporations is higher than the market value of the stock. This difference could be caused by a number of factors such as differences in price expectations, or corporate inefficiencies in management, marketing, distribution, etc. For whatever reason, mergers are pursued in hopes of acquiring needed reserves, or other assets, at a favorable price and creating more efficient production opportunities. These natural market opportunities permit the potential value to society of these reserves, or other assets, to be increased and can be viewed as simply an incentive for efficiency.

If some of these mergers are actually anticompetitive, the solution is to challenge them. If some of them prove to be unsound business decisions, the discipline of the marketplace will provide the solution. Either way, there is no need for special anti-merger legislation directed at the oil industry.

Proponents argue mergers will threaten exploration by siphoning off financial resources which could be used for exploration and development (E&D).

Legislation preventing mergers will actually reduce E&D because:

1. S.2362 will prevent E&D.

   Johnston bill will actually prevent companies from acquiring Federal leases or developing leases they already have if a right-of-way is needed. It will have exactly the opposite effect compared with its intended purpose.

2. Merged firms will have improved efficiency and cash flows.

   Some of these mergers may actually improve efficiency and competitiveness of survivor firms, thereby improving cash flows and profits and providing more resources for E&D activities.

   o For example, the Socal-Gulf merger, according to a major brokerage firm, will improve Socal's net by about $350 M in 1984 after interest on merger debt is paid. Cash flow will increase by about $2 billion (from postmerger depreciation, depletion, and amortization). These funds could be used for increased E&D.

3. Merged firms need new oil as badly as they would have separately.

   If the merged companies are going to maintain or improve the value of the new firms and stay in the oil and gas business, they will have to maintain or improve their level of reserves which will require the same or a larger investment for exploration.

   o A related point, the combined companies can pool information on geology and geophysics of exploration prospects and select the best drilling sites from a larger menu.

4. Lower drilling costs mean less cash needed for E&D.

   In the U.S., drilling costs have drastically declined since the speculative highs of 1978-81. The DOE estimates, for example, that onshore expenses have dropped by 1/3 since 1981. So even if a merged firm chooses to allocate fewer dollars to E&D, they may be able to finance more drilling.

5. Tax policies and leasing moratoria will have more of an impact on E&D.

   It has been clearly shown that tax policy can retard the search for new oil. A recent study points out that from 1980 to 1982 the U.S. oil industry paid taxes at a rate more than 60% higher than 200 big non-oil firms. Each dollar taken in taxes is one not available for E&D because the industry reinvests 80% of its earnings, much of it to find new oil reserves. In addition, the recent leasing moratoria on the OCS have prevented E&D activities in some of our most promising areas. While we recognize the need for State involvement and environmental protection, the arbitrary removal of tens of millions of acres will certainly reduce E&D activities in many promising OCS areas.

6. Merged companies will still have to drill their OCS lease tracts within 5 years to recoup their investments. The vast majority of OCS lease tracts require E&D within 5 years or companies will lose their leases. Overall, about 70% of leased OCS tracts are drilled within the statutory period. The 6 companies currently involved in merger activity own slightly more than 3 million acres of OCS lease tracts for which they paid hundred of millions of dollars.

	OCS Leases (thousands of acres)
Socal	987
Gulf	578.2
Texaco	479.1
Getty	401.3
Mobil	461.7
Superior	127.2
Total	3034.5

Companies will not walk away from these investments after merger and will proceed to explore and develop these leases unless prevented by an inability to acquire fill-in acreage or rights-of-way.

7. Recent FTC study of past oil company mergers found no capital diversion from E&D.

In 1982 the FTC completed a study of oil industry mergers from 1979 to 1981. The Oil Merger Study "found no substantial evidence that increased oil merger activity significantly diverted capital from exploration and development of energy sources." The Study found that indeed crude oil E&D generally increased during the period of increased oil merger activity.

4.0 Effects on Exploration

4.1 Recent History of U.S. Exploration

* Exploration activity is expected to increase from a recent - 1982- low of 1800 drilling rigs. (1981 experienced a high of 4500 rigs) Reasons:

1) exploration costs ~~so~~ are down due to surplus drill rigs ~~(see's data)~~

2) The 1983-84 price stability has given confidence to investors ~~that prices won't fall below $29/bbl.~~

3) petroleum reserve amounts are down

data: Rigs in use (weekly ave.) 1978 -- 2300

1981	4500	Christian Sci Monitor
1982	1800	Denver Post
1983	2232	
1984	2600	

4.2 Enactment of S. 2362 or similar legislation would hamper exploration

- Interventions of the sort contained in the bill will only increase the risk perceived by stock holders in connection with investments in oil companies.

- Expectations regarding future oil prices are down significantly. As recently as 1982 prices projected for 1984 - 1985 were $35 per barrel. However, the current spot price~~s~~ is about $25 per barrel.

4.3 Major oil companies are increasingly, pessimistic about finding major new reserves -- the failure to find oil after a ~~billion dollar~~ major investment ~~in the~~ at Mukluk, ~~field.~~

~~4.4~~ That makes existing domestic oil reserves all the more attractive to companies like Socal, Mobil and Texaco which can afford to buy them.

5.0 National Security Effects

- Mergers U.S. oil companies can only improve U.S. oil security by making U.S. oil companies more profitable.
- The merged companies with their larger reserves and larger refining and marketing capability must maintain their level of reserves or their production will fall.
- The larger profits of the post merger companies should enable greater exploration than tha~~n~~t possible by the pre-merger companies.
- If there is a disruption of free world's oil supply (larger than 5%) the U.S. will use the strategic Petroleum Reserve.

6.0 Capital Availability and Transfer -

- The money paid to share holders of the acquired companies are reinvested in the U.S. economy.
- Some of this money will find its way back into oil and gas exploration.
- To sustain production oil companies must discover new reserves. The larger post merger companies merely have larger requirements for new discoveries to maintain their combined production.
- The larger profits of the post merger companies should faciliate rather than ~~larger~~ hinder exploration.
- Some of the proposed mergers will result in reduced need for refining and marketing capital. Sale of these surplus assets should provide cash needed for exploration.

Chevron U.S.A. Inc.
1700 K Street, N.W., Washington, DC 20006

Frank W. Bradley
Vice-President

May 14, 1984

Mr. Chuck Trabandt
Chief Counsel
Committee on Energy and
Natural Resources
United States Senate
Senate Dirksen Room 358
Washington, D.C. 20510

Dear Mr. Trabandt:

In response to your request, attached is information for the record relating to the causes and impacts of oil company mergers and acquisitions.

Sincerely,

Frank W. Bradley

RESPONSES TO QUESTIONS
FROM THE
SENATE ENERGY AND MINERAL RESOURCES SUBCOMMITTEE
RELATED TO
RESTRUCTURING TAKING PLACE IN THE DOMESTIC OIL INDUSTRY: CAUSES AND IMPACTS OF MERGERS AND ACQUISITIONS

HEARING - April 10, 1984

CONDITIONS CAUSING RESTRUCTURING

1. Q. **What general conditions have led to or contribute towards mergers, acquisitions and the restructuring taking place in the domestic oil industry? What is the role of:**

   (a) **The decline in demand and the worldwide surplus of crude oil and excess capacity in the downstream sector?**

   (b) **The increased costs of finding and developing new domestic oil and gas reserves?**

   (c) **The availability of opportunities abroad for developing new reserves?**

A. The oil industry is going through another fundamental change -- one of the many during its existence. There have been periods of destructive competition: war years when maximum output was essential; inflationary periods with extremely complex price controls; and, periods of import controls -- first to keep out cheap foreign oil and later to keep domestic prices from reaching foreign oil prices. Now we have come to a time when anticipated future growth in demand for petroleum products is near zero. The attached chart shows demand for petroleum products to increase less than 1% per year through the year 2000.

(a) Under the low-growth scenario, continued growth in demand can no longer be counted on to increase profitability. Competition will be fierce for consumer dollars and companies will be striving for greater cost efficiency. Mergers are often a way of increasing cost efficiency. Furthermore, mergers reallocate resources to more valuable uses and it is obvious that some oil companies are finding the reserves of other oil companies significantly undervalued. Currently, refining and marketing assets are relatively less valuable because there is excess capacity - a result of overbuilding in the late 70's in anticipation of continued high levels of growth and, significantly, because of financial incentives provided to small refiners through government subsidies.

(b) The difficulty and cost of finding oil have increased rapidly in recent years. The onshore continental U.S. has been pretty extensively prospected. While many more worthwhile reserves of oil and gas will be found onshore and offshore in the U.S., it seems likely that most large oil and gas fields will be found in higher-risk, higher-cost frontier areas. But even in these areas, recent exploratory results have been disappointing, as the dry hole at Mukluk on Alaska's North Slope showed. So the oil industry is finding fewer good prospects for discovering new oil reserves in the United States today.

(c) Governments in foreign countries where we try to negotiate exploratory concessions are making demands that often make it uneconomic to do business. And even those terms are often later changed to our detriment in countries where exploratory efforts are successful. Host governments in some cases have taken over our operations entirely.

VALUATION OF STOCK

2. Q. What role has the valuation of oil industry corporate stock played? What factors have led to the apparent undervaluation of oil industry stock:

(a) Decline in demand for crude oil and natural gas?
(b) World surplus in crude oil supplies?
(c) Short and long-term price trends for crude oil?
(d) Excess capacity in the transportation, refining and marketing sectors?

A. Common stock shares of many oil companies have been depressed for several reasons:

- First, most government and industry economists believe that demand for oil in the U.S. will increase only very gradually for many years (see attached chart). Worldwide conservation, uses of other fuels, a deep recession and the ending of price controls in the U.S. have contributed to the slower growth in demand for oil.

- Second, there is a very large surplus of oil producing capacity around the world today. As a result of low demand for oil and a world surplus of oil supply, short and long-term price trends are expected to remain stable.

- And, finally, there is a great deal of excess refining and marketing capacity which must be consolidated if consumers are to be served efficiently. Some of this excess capacity has already been shut down, and more will be shut down in the future.

In summation, the prices of oil company stocks are low because demand has flattened out and there is so much surplus capacity, which led to reduced earnings and lower earnings projections. Oil stock prices tend to reflect this situation rather than underlying asset values.

IMPACT OF FEDERAL POLICY

3. Q. **What impact have Federal policies in the following areas had on the restructuring occurring in the oil industry?**

   (a) Federal lands and mineral leasing policy

   (i) onshore?
   (ii) Outer Continental Shelf?

   (b) Tax policy

   (i) Windfall Profit Tax?
   (ii) Tax provisions governing mergers and acquisitions?

   (c) Other State and Federal regulatory policies

A. (a) Actions by the United States government - and, to some extent, other levels of government - have withdrawn large areas of government land from exploration. As an example, some 85% of the California coastline is now off limits to oil and gas exploration because of moratoria. Thus, government has put off-limits some of the more promising areas where the industry was expecting to discover more oil and gas. We believe government restrictions play an important role in reducing the number of prospects available in the U.S. today.

(b) (i) Government is also responsible for the so-called "windfall profits tax," which takes billions of dollars each year out of the pool of capital that would otherwise be available for oil and gas exploration and development. As a matter of interest, Socal's and Gulf's total windfall-profits-tax-payments during the last three years amounted to $4.7 billion. Socal's and Gulf's total expenditures for exploration during this same period, including both capital expenditures and amounts charged to expense, were $5.9 billion. Thus our two companies could have increased their exploratory effort by about 80% if there had been no windfall profits tax and we had the prospects to drill.

(ii) There has been some concern over the way taxable corporate acquisitions have been structured in order to step-up the tax basis of the acquired corporation's assets as much as possible for the purpose of taking greater future tax deductions, while minimizing the required recapture of tax benefits previously taken on the assets of the acquired corporation. These benefits include, among others, accelerated depreciation, intangible drilling costs, and investment tax credits. Past approaches have included picking and choosing assets on which to take a stepped-up basis, thus avoiding certain undesirable tax recaptures, as well as deferring tax recaptures on the assets selected.

We believe this approach is no longer possible under the Tax Equity and Fiscal Responsibility Act of 1982. TEFRA substantially tightened the rules for stepping-up assets. This new law provides that, in corporate acquisitions which involve buying 80% or more of the stock of a corporation, the acquiring corporation may elect to have the value of the corporation's assets stepped-up to the purchase amount. However, the election must be made on an all-or-nothing basis.

More significantly, in order to take advantage of the step-up election, the acquired corporation must pay recapture taxes on previously taken tax benefits. The all-or-nothing approach precludes picking and choosing which assets to step up in the acquired corporation, and addresses the concerns of the past. As a matter of fact, this all-or-nothing approach tends to impede normal business transactions between acquiring and acquired corporations and their affiliates.

And, finally, the tax deductibility of interest payments is available to all borrowers and thus represents no more of a subsidy in merger transactions than the deductibility of interest payments on other business and personal borrowing.

(c) We have no comments with respect to the possible impact of other State and Federal regulatory policies on mergers and acquisitions.

ADVANTAGES OF RESTRUCTURING

4. Q. In general terms, what advantages flow from the restructuring now occurring in the domestic oil industry? Specifically, what is the impact of mergers and acquisitions on:

(a) Efficiency?

(b) Consumer cost?

(c) Industries' ability to raise the capital required for high cost frontier exploration, development and production?

A. (a) Depending on the circumstances, mergers and acquisitions can lead to economies of scale and improved efficiencies. The Socal-Gulf merger, for example, will bring together the exploration and producing resources of the two companies in a new combination that will be greater than the sum of its parts. The combined technical knowledge and capabilities can be applied to advance the exploration and development objectives of both companies, resulting in a more effective program than what could have been carried forward individually. Further, the economies of scale which would be created, and reduction or elimination of duplicate overhead and other non-development related expenditures, should allow better, more productive use of the companies' combined financial resources and technical people.

(b) Improved efficiency and economies of scale will tend to reduce consumer cost.

(c) The increasing costs and risks of developing reserves in frontier areas, both in the United States and abroad, require that companies be larger and stronger technically and financially if they are to explore and develop these prospects. Larger companies clearly serve the national interest in developing these frontier areas. It is also in the national interest to have companies that are strong enough to compete with large foreign oil companies - many supported by their governments - in acquiring and developing concessions abroad.

DISADVANTAGES OF RESTRUCTURING

5. Q. In general terms, what disadvantages, if any, result from mergers and acquisitions?

A. In the short run, there may be some redundancies of operation occurring with mergers. To correct this situation, some reductions in manpower and facilities in the merged companies will be necessary. The Socal-Gulf merger will preserve more jobs than any other alternative available. We believe that Gulf as a going concern has a value in excess of the value of its assets alone. We hope to preserve as much of Gulf as possible as a going operation, whether as a part of our own or some other company's operations. Over the long term, an efficiently run oil industry holds better prospects for jobs and income generation for its employees and for workers throughout the economy than one that is inefficiently run.

CONCENTRATION LEVELS

6. Q. What are the current levels of concentration in the oil industry?

(a) How do these levels compare with other major industrial sectors such as steel, automobiles?

(b) What impact have recent mergers and acquisitions had on concentration levels in the domestic oil industry?

A. The market share estimates presented in the following table and summarized below are based upon 1982 data contained in API's Market Shares and Individual Company Data for U.S. Energy Markets: 1950-1982, November 1983. All figures refer to domestic markets. The measures presented in the table have been computed assuming a full combination of the firms which recently announced merger intentions. In fact, some assets, especially in refining and marketing, will be divested and we should point out that, with respect to the Socal-Gulf merger, on April 26, 1984, the Federal Trade Commission approved an agreement, entered into by Socal, Gulf and the Commission staff, that requires Socal to sell off a substantial amount of marketing, refining and pipeline assets as a condition of approval of the merger. Thus, the estimates below are upper bounds to the mergers' effects on market concentration.

A Socal-Gulf combination would rank first in refining capacity and gasoline sales; third in oil production and natural gas production; and sixth in oil reserves. This combination's market share would range from 5.3 percent in natural gas production to 13.6 percent in refining capacity.

A Texaco-Getty combination would rank first in natural gas production; fourth in oil production, oil reserves, and gasoline sales; and fifth in refining capacity. The combined firm's market share would range from 5.6 percent in natural gas producton to 6.8 percent in gasoline sales.

If both mergers are consummated, four-firm concentration in oil production and reserves would rise slightly. However, four-firm concentration would rise by 3.7 percentage points in natural gas production, 4.9 percentage points in gasoline sales, and 5.0 percentage points in refining capacity. Twenty-firm concentration ratios would rise by about 1-2 percentage points.

The U.S. Commerce Department's Census of Manufacturers provides data on the share of each manufacturing industry's shipments accounted for by the four largest firms in the industry. This is the most common measure of industry concentration. The Census indicates that about 59 percent of all manufacturing industries, which accounted for about 61 percent of total shipments in manufacturing, had four-firm concentration ratios of at least 30 percent in 1977 (the latest data available). About half of these industries had four-firm ratios above 35 percent. Even if the Texaco-Getty and Socal-Gulf mergers are completed, the principal segments of the U.S. petroleum industry -- oil production, natural gas production, and gasoline sales -- would have four-firm ratios below 35 percent with only refining just at 35 percent. Hence, they still would be less concentrated than the majority of U.S. manufacturing industries.

U.S. CONCENTRATION RATIOS

	TOP 4 FIRMS 1982, % OF TOTAL		TOP 8 FIRMS 1982, % OF TOTAL		TOP 20 FIRMS 1982, % OF TOTAL	
	Before	After (1)	Before	After (1)	Before	After (1)
Crude & NGL Production (Thousand Bbls/day)	25.1	26.8	39.1	44.9	58.5	59.6
Natural Gas Production (Millions of Cubic Feet)	16.7	20.4	27.7	31.7	45.5	46.9
Crude and NGL Reserves (Millions of Bbls)	29.8	30.0	44.5	49.3	60.9	61.7
Natural Gas Reserves (Billions of Cubic Feet)	23.4	24.3	35.7	38.5	54.1	55.4
Refining Capacity (Thousand Bbls/day)	29.9	35.0	49.5	54.6	77.3	79.7
Gasoline Sales (Millions Gals/year)	26.6	31.4 (2)	47.3	50.5 (3)	69.1	70.7
Coal Production (Thousand Tons)	20.6	20.6	30.2	30.2	49.7	49.7

URANIUM

1982 U.S. Holdings by All Oil Companies

Production	31.0% (Socal 3%)
Reserves	21.0%

PIPELINES

Chevron and Gulf have an interest in competing pipelines from the U.S. gulf to the northeast:
Plantation Pipeline (Chevron 27.13%)
Colonial Pipeline (Gulf 16.78%)

Footnotes:

(1) 1982 data recalculated to include effects of Socal/Gulf and Texaco/Getty mergers under the assumption that no divestitures are made.
(2) YTD '83 = 31.72%
(3) YTD '83 = 52.54%

Source: API Discussion Paper #014, Nov. 1983

EXPLORATION AND PRODUCTION

7. Q. **What impact, in general, do mergers and acquisitions have on exploration, development and production of domestic oil and gas reserves?**

   (a) **What role have previous mergers and acquisitions played in the development of today's domestic oil industry and its ability to develop frontier areas and compete internationally?**

   (b) **What impact have recent (since 1975) mergers and acquisitions had on the combined company's exploration, development and production budgets?**

A. Levels of oil exploration and production are determined principally by anticipated prices that can be obtained for oil and gas reserves and production, the costs of finding and producing these resources, and taxes. Thus, the amount of capital devoted to oil exploration and production will depend primarily on these factors, and not on merger activity. Basically, a merger or acquisition does not reduce the total funds available for investment spending. Monies spent by one company to buy another are merely transferred from the acquiring company to the sellers of stock in the acquired company. The total amount of money available for investment in oil exploration, development and production therefore is unchanged.

Further, companies that purchase existing reserves will have improved, secure cash flows from production of the added reserves, and they will actually be in a stronger financial position for finding and developing new oil. The high risks and high costs of frontier area exploration activity will be spread over a broader financial base.

(a) There is so much competition and so little market concentration in the oil industry it is difficult to quantify the impact of past mergers such as U.S. Steel-Marathon, Conoco-DuPont and Cities Service-Occidental. We observe, however, that gasoline prices, which reached their peak just following price decontrol in January of 1981, have declined fairly significantly and steadily (in spite of excise tax increases) since that time. This certainly suggests that these mergers in no way contributed to reduced competition.

(b) Recent experience has shown that mergers do lead to increased production and stronger competition. For example, Shell Oil acquired Belridge Oil in 1979, and primarily through the use of advanced recovery technologies, about doubled that company's oil production over three years time. For another, the Standard Oil Company of Ohio sold a large block of its shares (about 55%) to British Petroleum in the 1970's and used the money to develop and produce its very substantial oil discoveries on the North Slope in Alaska. And for yet another, the merger of the Atlantic Refining Company and Richfield Oil to make up Atlantic Richfield in the 1960's resulted in a company, Arco, capable of competing nationwide and which has become one of the principal developers of Alaskan oil.

COMPETITION

8. Q. What impact do mergers and acquisitions in the domestic oil industry have on competition within the industry?

(a) Does divestiture, by order or consent decree, lead to more or less competition?

(b) Are there specific problems faced by independent refiners, marketers and retailers of petroleum products resulting from mergers and acquisitions which are not adequately covered by existing law?

(c) What is the effect of increased competition on industry efficiency and consumer prices?

A. (a) After completion of the announced mergers, the oil industry is and will remain highly competitive. Current antitrust laws provide for careful review of mergers on a case-by-case basis. If local submarkets appear to become less competitive as a result of a merger, current law and procedures provide remedies to prevent such an occurrence. Socal has already agreed to remedy any concentration problem in local markets resulting from the merger with Gulf.

(b) We are not aware of any particular problems resulting from mergers and acquisitions that are not adequately covered by existing law. We believe all segments of the industry are facing similar problems, or opportunities, which are a result of increased competition.

(c) The United States oil industry has an extremely large number of participating companies. There are about 10,000 active exploration and production companies of all sizes. There are over 130 separate companies that own and operate refineries. There are about 15,000 wholesalers and countless independent trucking companies involved in distributing and marketing petroleum products. And the vast majority of the nation's 140,000 retail service station outlets are operated as separate businesses by independent dealers. The restructuring now taking place throughout the industry will result in more strongly marked competition. This is a normal and healthy part of our free economy, whereby certain companies can become more efficient, thus benefitting the consumer.

ANTITRUST LAWS

9. Q. Are the existing laws, policies and institutional arrangements governing competition and antitrust matters adequate to govern any competitive problem associated with oil industry mergers and acquisitions?

A. Yes. The Department of Justice and the FTC have developed detailed guidelines by which to judge the competitive effects of mergers. Mergers can be pro-competitive or anticompetitive depending on the circumstances. Too much concentration in an industry can create incentives to reduce output and increase prices. On the other hand, merged entities can have significant economies of scale and other efficiencies which bring products to the marketplace at a lower cost and hence lower prices. The present merger guidelines, adopted by both the Department of Justice and the FTC, recognize the sensitivity of the issue and set out a rational and reasonable methodology to deal with it. J. Paul McGrath, head of the Antitrust Division of the Department of Justice, stated in a speech on March 8 that:

> "Government merger policy strongly effects the economy. The free movement of business assets is critical to economic growth. For that reason, business managers must be free from irrational antitrust constraints in deciding whether to acquire or divest businesses. Antitrust enforcers should only block mergers when they conclude, based on sound economic analysis, that a particular transaction will adversely affect competition."

The guideline's basic test, the Herfindahl Index, looks at pre-merger and post-merger concentration figures. If the concentration levels remain below certain trigger points, the government will not block the merger. If the merger produces concentrations above that trigger, the government will thoroughly investigate and most likely will challenge the merger.

The Herfindahl Index acts as brake for any "slippery slope" effects of industry mergers. Every subsequent merger in an industry increases the concentration numbers, so that before critical concentrations are reached in an industry, the government will automatically block further mergers.

In sum, under the merger guidelines, industries are precluded via the merger mechanism from becoming concentrated to the point where a few firms have significant market power. Under those circumstances, mergers not in violation of the guidelines should be left to the free market.

REVENUE FROM FEDERAL LANDS

10. Q. **What is the probable impact of oil industry mergers and acquisitions on Federal revenues derived from exploration, development and production of Federally-owned oil, gas, coal, oil shale and other energy resources?**

A. Federal revenues from existing exploration, development and production activities will not change. Mergers tend to bring together the exploration and producing resources of two companies in a new combination that will be greater than the sum of its parts. It should result in a more effective exploratory program than the companies would have carried forward individually.

The very fact that a merger or acquisition takes place does not cause a reduction in the total funds available for investment spending. The acquisition of reserves is accomplished primarily through borrowing, as in the case of the Texaco/Getty acquisition, and the Socal-Gulf merger. Therefore, a company's investment program for exploration and production is a function of the number of attractive prospects available and the anticipated return on investment in those prospects. Actually, we believe the inability of the industry to access Federally-owned resources impacts more on Federal revenues than mergers. For example:

- In the last three years more land has been taken out of circulation for exploration than was leased in the last 30 years.
- In California, the sight of the country's hottest exploration activity, 85% of the coast is under moratorium for OCS leasing.
- The leasing of the most attractive frontier area in the U.S., the Marsh Creek Anticline in Alaska with a possible 14 billion barrels of reserves, is under a congressionally mandated delay.

CREDIT MARKETS AND INTEREST RATES

11. Q. What impact do mergers and acquisitions in the domestic oil industry have on:

(a) domestic credit markets?
(b) interest rates?
(c) shareholders?

A. The credit used to finance the recent mergers does not tie up these funds to the detriment of other borrowers. Acquisitions and mergers are basically financial transactions in which shareholders of the acquired firms receive cash in exchange for their equity shares.

(a) Testifying before the Senate Judiciary Committee on March 15, 1984, Mr. Leif H. Olsen, Chairman of Citibank's Economic Policy Committee, had the following comments on the credit impacts of the Socal-Gulf merger:

> "A $13.2 billion transaction may seem large in absolute terms but when placed in the context of the $1.2 trillion gross transactions undertaken in the equity market last year, it represents 1.4 percent. Compared with gross bank lending and investing of more than $4 trillion, it represents one third of one per cent ...
>
> "The Socal acquisition of Gulf Oil is, instead, a purely financial transaction in which the borrowed money would pass swiftly to the shareholders of Gulf. They would then use these proceeds to buy other stocks or bonds. So given the fungibility of money, the proceeds from the Gulf purchase by Socal would flow back into the money markets where they would be available to finance business.

No credit is withheld from other borrowers ... Furthermore, that part of the $13.2 billion received by Gulf shareholders which is paid in taxes (perhaps about $2 billion) will offset the need for an equivalent amount of borrowing by the Federal government."

(b) The part of the $13.2 billion that is not taxed will be largely reinvested. This means that upward pressure on interest rates will be shortlived and minimal. The part of reinvested funds that goes to buy stocks will make it attractive for industries to expand by issuing equity, thus reducing some need for corporate borrowing. The part that goes to bonds and other debt instruments will merely replace the amount of credit that was lost.

(c) Shareholders will benefit from the economic reordering of their investments through mergers. Mergers are part of the fundamental process through which capital markets efficiently operate to more accurately value the assets of petroleum companies. Recently, the oil industry's perception of the real value of its own assets has been quite different from that of stock market investors, and the recent merger activity has, in large measure, reduced this discrepancy.

TAX REVENUES

12. Q. (a) What impact do mergers and acquisitions have on tax revenues to the Federal Treasury?

(b) Are there provisions of the Tax Code which encourage or provide incentives for the merger or acquisition of domestic oil companies?

(c) What impact have recent amendments to the Tax Code, including the provisions recently adopted by the House and Senate, had on mergers and acquisitions in the oil industry?

A. (a) There is not enough information on the money flows and tax payments resulting from mergers and acquisitions to accurately assess the impact on tax revenues to governments. However, the Socal-Gulf merger essentially affects the Federal Treasury in the following areas:

1. The taxable gain recognized by the current Gulf shareholders. Socal's offered purchase price of $80/share for the Gulf stock is roughly twice the Gulf stock price a year ago. Accordingly, the Gulf shareholders will have a gain of about $6.6 billion over this period. It seems likely that the Gulf shareholders will pay about $2 billion in increased taxes in 1984.

2. Socal will incur interest expenses on borrowed funds to purchase the Gulf stock. In 1984, the amount will be on the order of $600-800 million. On the other hand, the cash proceeds to the current Gulf shareholders will either be earning interest or be reinvested. The net tax effect of these transactions will be minimal.

Mr. J. Paul McGrath, head of the Justice Department's antitrust division, was quoted in the New York Times on March 9, 1984 to the effect that "mergers do not appreciably lessen aggregate savings."

(b) While we cannot comment with authority on aspects of the Tax Code with respect to mergers and acquisitions in general, we can say that the idea of gaining tax benefits was not a factor in considering the Socal merger with Gulf. In fact, our considerations centered on determining whether taxes would stand in the way of the merger. Accordingly, we do not believe the Tax Code encourages or provides incentives for the merger or acquisition of domestic oil companies (also see answer to item 3, this questionnaire).

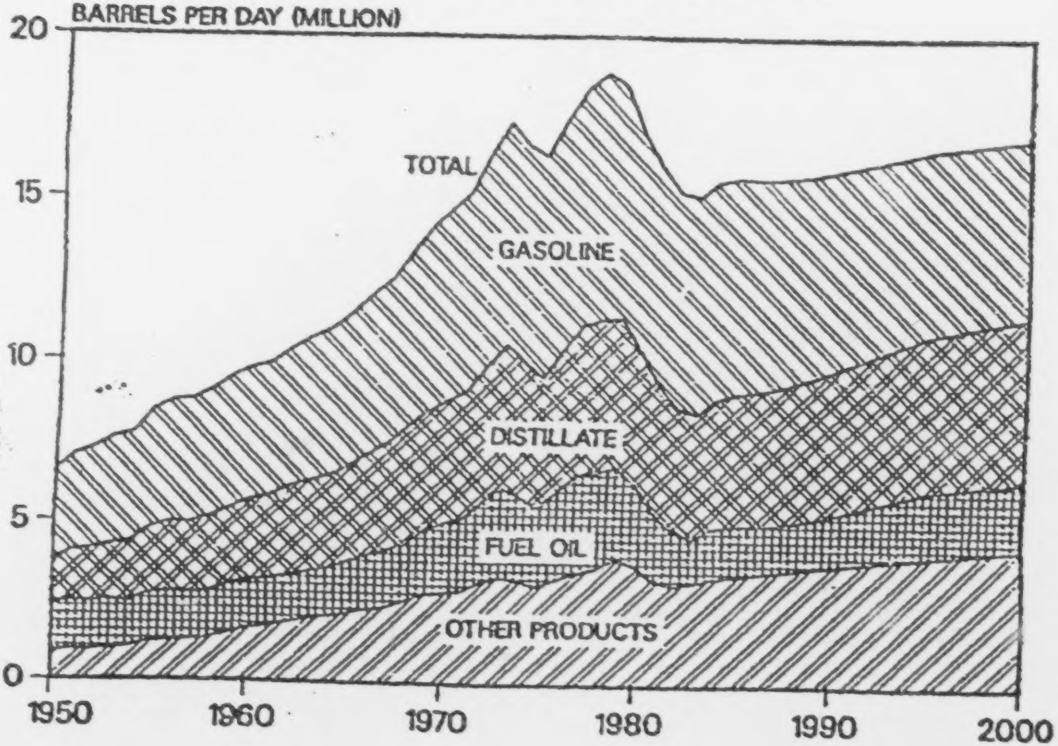
(c) Recent amendments to the Tax Code, including TEFRA, minimize any special tax benefits that might arise from friendly mergers of continuing businesses.

Attachment

GJK - 5/9/84

Attachment 1

U. S. PETROLEUM DEMAND



Gulf Oil Corporation
PUBLIC AFFAIRS DEPARTMENT

Charlotte Rush
DIRECTOR
FEDERAL RELATIONS

Suite 700
1025 Connecticut Ave., N. W.
Washington, D. C. 20036

April 26, 1984

Mr. Charles Trabandt
Senate Energy and Natural Resources
SD-358 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Chuck:

Pursuant to Senator Warner's request for supplemental information on oil company mergers during his April 10 hearing Gulf respectfully submits the following:

1. Testimony of J. E. Lee, Chairman of the Board and Chief Executive Officer, Gulf Corporation before the Senate Judiciary Committee, March 15, 1984.

   Mr. Lee's testimony addresses the oil industry merger moratorium legislation proposed by Senator B. Johnston (D-LA) and the circumstances leading to Gulf's merger with Standard Oil Company of California. Gulf's commitment to both shareholders and the nation's future supply of secure energy reserves were the most significant considerations in Gulf's decision-making.

2. Testimony of J. L. Murdy, Executive Vice President, Gulf Corporation before the Subcommittees on Commerce, Transportation and Tourism and Fossil and Synthetic Fuels of the House Energy and Commerce Committee, March 21, 1984.

   Mr. Murdy's testimony addresses the stock markets behavior regarding Gulf stock in late 1983 and early 1984. It discusses the industry environment and federal policies which have contributed to the current depressed state of the industry, and argues against merger moratoria legislation.

3. Gulf Corporation Answers to Questions for Witnesses submitted to the Subcommittees on Commerce, Transportation and Tourism and Fossil and Synthetic Fuels of the House Energy and Commerce Committee.

   Gulf's responses to a broad range of topics including: competition in the industry, antitrust laws, consumer impacts of mergers and merger effects on credit markets.

TELEPHONE: 202/659-8720

4. Testimony of J. L. Murdy before the Subcommittee on Energy and Agricultural Taxation of the Senate Finance Committee, April 5, 1984.

   Mr. Murdy's testimony discusses the tax aspects of the circumstances which contributed to the Gulf/Socal merger. The testimony addresses the significant advantages accruing to corporate speculators under existing tax law from the distribution of a royalty trust, which attracted the speculative interest in Gulf stock preceding the merger agreement.

5. Written submission of Mr. J. L. Murdy before the Subcommittee on Energy and Agricultural Taxation of the Senate Finance Committee, April 5, 1984.

   Mr. Murdy's written statement includes a description of Gulf and Socal, the origins of the merger, Gulf's response to the industry environment, speculator attacks on Gulf, the Gulf/Socal merger's compliance with applicable laws, and the national need for large energy companies.

6. Testimony of Mr. J. L. Murdy before the Subcommittee on Energy and Mineral Resources of the Senate Energy and Natural Resources Committee, April 12, 1984.

   Mr. Murdy's testimony discusses how the Socal/Gulf merger is consistent with national energy policy.

7. Vital Statistics of the Gulf/Socal Merger.

   Statistical data on the individual and combined firm's financial, reserve and production results for 1981 through 1983.

8. Gulf Does Not Have Any Visible Alternative To The Merger with Socal.

   A discussion of Gulf's decision to agree to a prompt merger with Socal, in the interest of shareholders and the nation.

9. Gulf Corporation Response to Mesa's Royalty Trust Proposal, February, 1984.

   A memorandum prepared by Gulf, in consultation with its financial advisors Salomon Brothers Inc. and Merrill Lynch Capital Markets, to present in detail the reasons for Gulf's rejection of the Mesa Royalty Trust Proposal.

10. Gulf Oil Corporation Operational and Financial Briefing, December 14, 1983.

    The texts of remarks and a collection of charts and maps used at the December 14, 1982 meeting of Gulf management with 114 financial analysts and reporters. Highlights of questions and answers are also included. The booklet includes a Corporate Overview of Gulf's strategy, objectives and progress through 1983, a financial review, and projections and outlooks for crude and product markets. Also included are discussions of Gulf's exploration strategy, marketing realignment and other operations and issues.

11. Tax Avoidance and The Royalty Trust.

    An in depth analysis of the tax incentives for corporate speculators' investments in oil and gas royalty trust distributions.

12. Annual Reports of the Gulf Oil Corporation, 1979-1983.

Should you require any additional information or have questions on the enclosed material, please let me know.

Sincerely,

Charlotte Rush

Enclosures
cr0002

[Subcommittee Note. -- The following list indicates additional material submitted by Gulf Corporation; the documents have been retained in Subcommmittee files for the record. The publications can be obtained through Gulf Corporation.]

1. Gulf Corporation, Response to Mesa's Royalty Trust Proposal. February 1984.

2. Operational and Financial Briefing, Pittsburgh, Pennsylvania. December 14, 1983.

3. Tax Avoidance and the Royalty Trust.

4. Securities and Exchange Commission Form 10-K Annual Report, Gulf Oil Corporation. December 31, 1980.

5. Securities and Exchange Commission Form 10-K Annual Report, Gulf Oil Corporation. December 31, 1981.

6. Gulf Oil Corporation 1979 Annual Report.

7. Gulf Oil Corporation 1980 Annual Report.

8. Gulf Oil Corporation 1981 Annual Report.

9. Gulf Oil Corporation 1982 Annual Report.

10. Gulf Corporation 1983 Annual Report.

TESTIMONY

OF

JAMES E. LEE
CHAIRMAN OF THE BOARD
AND
CHIEF EXECUTIVE OFFICER
GULF CORPORATION

BEFORE

THE JUDICIARY COMMITTEE
UNITED STATES SENATE

March 15, 1984
Washington, D.C.

Good afternoon. I'm Jim Lee, Chairman of the Board and Chief Executive Officer of Gulf Corporation. Senator Thurmond, I would like to thank you and your committee for this opportunity to expand upon the letter I sent to you earlier about the merger between Gulf and Standard of California.

Gulf and Socal agreed on this merger ten days ago, following our Board's February 24th decision in principle to explore such a possibility. Both companies made their initial Hart-Scott-Rodino filings March 6. On Gulf's part, that decision represented the best available alternative to a liquidation plan, which a minority shareholder is trying to impose on us. The Socal cash offer of $80 per share, in our opinion, is a strong, fair offer to all of our 260,000 shareholders.

This decision, and those before and after it, was guided by underlying management philosophies to which our directors and I are deeply committed. One is to protect the investment of our stockholders and to increase its value. Another is a commitment to strengthen the energy security of our nation.

Gulf and Socal are meticulously following the requirements of all applicable statutes and regulations. Both George Keller and I have pledged to resolve any potential anti-trust problems. All the parties involved in this transaction have followed the rules governing mergers.

Now, there are proposals to change the rules retroactively. I must tell you that to change them for Gulf, after the fact, is wrong and will only have serious undesirable consequences.

Congress should understand that Gulf is currently facing two tender offers, one by Socal at $80 per share for all of our stock, and another aimed at gaining a controlling interest in our company by buying only some of the shares for $65. The clock is running on both of these offers.

If the Socal $80 offer is delayed as a result of Congressional action, the lesser, partial offer of $65 has a good chance of succeeding. That result would be catastrophic for our 260,000 shareholders and devastating for our 42,000 employees. Since the strategy behind the partial $65 offer includes a random liquidation of Gulf assets, it would not be in the best interests of the nation.

We believe that Socal is committed to a continuation of the strategies to which Gulf has dedicated itself. Gulf has made significant progress in its efforts to implement these strategies for increasing stockholder value and for developing the energy reserves needed by Gulf and the nation over the long term.

Yet, this progress did not significantly affect Gulf's short-term profitability. Although we were making great strides, market forces and events overtook us. Gulf stock remained undervalued, and we became the target of a well-financed and aggressive group of speculators.

The attention generated by the battle for control of Gulf created such a frenzy on Wall Street that we were finally compelled to recognize that Gulf's survival as an independent company was no longer a viable alternative. Our stock price had been forced up to a point that could not be sustained by current earnings or near term prospects. After weighing the alternatives, Gulf's best option was a friendly merger consistent with our determination to increase stockholder value and strengthen the nation's energy security.

With this uppermost in our minds, our Board decided ten days ago that the merger offer presented by Standard Oil Company of California best served Gulf stockholders, employees, customers, and the nation. As George Keller assured the committee in his statement, Gulf's jobbers, retail dealers, and customers will continue to have access to an adequate supply of petroleum products through the transition period. All of Gulf's current supply contracts with jobbers and dealers will be honored, consistent with FTC requirements.

Enactment of legislation which would retroactively prohibit the Gulf/Socal merger is bad public policy. Both firms acted responsibly, within the framework of existing laws, and chose an action based on the best business judgements of their boards of directors.

If Congress determines that changes are necessary to prohibit speculators from reaping short-term gains by breaking up energy companies in the future, tax law changes now before Congress will help solve that problem. However, legislation to prohibit or delay actions by Gulf and Socal, which were taken in light of established rules and regulations, will do serious damage to Gulf, its shareholders and the ability of the marketplace to provide an efficient domestic energy industry.

The six-month moratorium contemplated by Senator Johnston's bill would be particularly devastating for Gulf. It would put us in limbo, unable to make major decisions or capital commitments, or to keep and protect our best employees. Our merger with Socal provides the best opportunity for our best people to continue their careers as part of a strong, growing and competitive company.

Gulf's survival is no longer a viable alternative. Gulf has been sold by the marketplace; and the sale will either take place through the merger with Socal, the Mesa Group's tender offer, or as the result of a proxy contest that would force the company's liquidation. Obviously the Socal merger is the best -- indeed the only one -- of these alternatives. It provides cash to all of our shareholders for all of our stock. It prevents the random liquidation of Gulf's assets. It protects jobbers, dealers, and customers. It assures continued employment for most of our employees.

I strongly recommend that this Committee consider whether some legislative action may be appropriate to save other companies from Gulf's fate. But for us it is just too late. You can only make Gulf's situation worse unless it is made clear that our merger with Socal will be excluded from your considerations.

TESTIMONY
OF
JAMES L. MURDY
EXECUTIVE VICE PRESIDENT
GULF CORPORATION
BEFORE
THE SUBCOMMITTEE ON COMMERCE, TRANSPORTATION AND TOURISM
AND
THE SUBCOMMITTEE ON FOSSIL AND SYNTHETIC FUELS
OF THE
ENERGY AND COMMERCE COMMITTEE
UNITED STATES HOUSE OF REPRESENTATIVES

March 21, 1984

Washington, D.C.

Good morning. I'm Jim Murdy, Executive Vice President of Gulf Corporation. I have four other executives of the corporation with me today; Mr. Murphy our General Counsel, Dr. Bowman who heads our downstream operations, Mr. Bibee, Chief Exploration Officer, and Dr. Wainerdi who is responsible for Gulf's research. We thank you for this opportunity to provide you with Gulf's views on legislation which would prohibit or postpone Gulf's merger with Standard Oil of California (Socal).

Our merger with Socal is consistent with the national interest, is best for our shareholders, and does the most to protect our employees, jobbers, dealers, and customers. That's why we believe proposed moratorium legislation is ill-advised.

It's unfair to both companies and to the nearly half a million shareholders who hold stock in the two firms. Both companies are acting responsibly, within the framework of existing laws, and have chosen an action based on the best business judgements of their boards of directors.

This legislation is too late if it's designed to preserve Gulf as a strong, independent company. Gulf has been sold by the marketplace and its survival is no longer a realistic alternative. The only question is whether we will be allowed to merge with Socal, or be forced into some form of liquidation through the Mesa Group's tender offer, or a hostile proxy contest.

How did Gulf come to this point? The answer is found in the marketplace and in the signals that have been sent to it.

Oil company stocks trade on their dividend yield and near term earnings outlook. What is important in Gulf's case has been the wide gap between that value and our potential liquidation value. This was a direct invitation for speculators to move aggressively into our stock. Since the value gap couldn't be closed in the near term by normal operations, the only possible outcomes became a friendly merger, a hostile takeover, or self liquidation.

Today, the petroleum industry is characterized by ample supplies of crude oil, surplus refining capacity and moderating demand for our products. Prices have fallen, industry earnings have come under pressure, and dividends, while increased, have barely kept pace with inflation.

The federal government has also played a major role in making the petroleum industry unattractive to long-term investors. Following decontrol, the windfall profits tax prevented the industry from making full use of the cash flow a competitive market produced. Those dollars were siphoned away from exploration and development, and from the returns earned by investors. In addition, natural gas remains controlled under the Natural Gas Policy Act and severe restrictions have been placed on some of the most promising areas for exploration, especially offshore federal lands.

I am not here to argue the wisdom of those policies. But they are policies which sent a strong signal to investors. Investors have looked at the reduced demand for energy -- and poor prospects for future profits. That's why they placed a low value on oil company stocks. In fact, Gulf's value dropped to well below our book value.

Therefore, we at Gulf sought to improve our profits by restructuring our operations. During the last two years, Gulf made significant progress, but market forces and events overtook us. Gulf's stock remained undervalued, and the company became the target of a well-financed, aggressive group of speculators.

The attention generated by the recent battle for control of Gulf created tremendous pressure from Wall Street. Our stock price was forced up to a point that could not be sustained by current earnings or near term prospects. The market began to price our stock solely on our liquidation value.

That's why, after weighing the alternatives, Gulf's best option was to accept the merger offer presented by Standard Oil of California. That offer best serves Gulf stockholders, employees, jobbers, dealers, customers, and the nation.

If Congress wants to keep speculators from grabbing for short-term gains by breaking up energy companies, proposed tax law revisions now before Congress will help solve that problem. However, at this point, legislation to prohibit or delay Gulf and Socal from moving ahead will do serious damage to our shareholders and the capital markets.

The six-month moratorium in Senator Johnston's bill would be particularly devastating for Gulf. It would put us in limbo. We couldn't make major decisions or capital commitments and we couldn't keep our best people. Our merger with Socal is the best opportunity for our good people to continue their careers as part of a strong, growing, competitive company.

Congress should understand that Gulf is currently facing two tender offers, one by Socal at $80 per share for all of our stock, and another aimed at gaining control by buying only some of the shares for $65. The clock is running on both of these offers.

If the Socal offer is delayed as a result of Congressional action, the lesser offer has a good chance of succeeding. That result would be terrible for our 260,000 shareholders and harmful for our 42,000 employees.

You can only make Gulf's situation worse unless you allow our merger with Socal to go forward under existing laws and regulations. A moratorium, in our case, is unnecessary and extremely unfair.

GULF CORPORATION ANSWERS
TO
QUESTIONS FOR WITNESSES
SUBMITTED TO
THE SUBCOMMITTEE ON COMMERCE, TRANSPORTATION AND TOURISM
AND
THE SUBCOMMITTEE ON FOSSIL AND SYNTHETIC FUELS
OF THE
ENERGY AND COMMERCE COMMITTEE
UNITED STATES HOUSE OF REPRESENTATIVES

March 21, 1984

Washington, D.C.

1. Could a concentrated, uncompetitive oil industry rapidly develop as a result of the current merger wave? If it does, how could the resulting harm to consumers be remedied "after the fact"--when previously vigorous competitors may have already disappeared?

Answer

Such a development is highly unlikely. The industry is now very competitive and quite unconcentrated. A number of highly improbably transactions would have to occur over a considerable period of time to change this basic nature.

The Hart-Scott-Rodino review process is already in place to provide the government's experts with adequate time and information to study every merger of any significance. If evidence should begin to develop that an unwarranted degree of concentration may be in the offing, the government will be both forewarned and forearmed as a result of laws already in place.

For the above reasons, we believe the second question to be academic. Even if it were not, the FTC and Justice Department can freeze corporate entities in place so that "vigorous competitors" cannot disappear before the government can act. For example, Texaco is required to keep Getty's assets in a "hold separate" posture until the period for public comment on the FTC Consent Order has expired. Finally, in the past, antitrust courts have not had any difficulty undoing an unlawful merger where they feel such a step is necessary, and they have even required that new competitive entities be created.

2. Does the current merger activity result from a change in antitrust enforcement policy that amounts to a de facto rewrite of the antitrust laws? Would mergers this large have been contemplated or completed under previous administrations?

Answer

If by the "current merger activity," the question refers to the three most recent transactions in the oil industry, the answer is "no." In each of these cases, the merger is a result of unique, individual circumstances which drove one of the merging companies into the arms of a "White Knight;" Getty and Superior by disputes among family members with very large blocks of stock; Gulf, by the speculative onslaught of the Mesa Group.

If the question is broader than that, the answer is still "no." The Administration's response to transactions in the steel industry shows that each case will be judged on its own merits. This is the very essence of good antitrust analysis.

Size is a relative concept. Oil companies tend to be very large because their business involves very large risks. Don't forget that, although Socal and Gulf are both in the top ten of domestic oil companies, the merged company will be very much smaller than Exxon and smaller than Mobil without Superior.

If the same circumstances had existed under prior Administrations, at least over, say, the last ten years, such mergers probably would have been undertaken. It has been a long time since the rule was that any strained market definition or economic construct could be used to defeat all economically useful mergers.

3. If mergers as large as Texaco-Getty and Socal-Gulf are legal, what mergers might be illegal? Can there be such a thing as an illegal oil industry merger anymore?

Answer

The absolute size of a merger is irrelevant. Any merger might be illegal -- even one involving much smaller companies -- if it resulted in undue concentration in particular products or territories or was undertaken for some sort of anticompetitive purposes, such as the stifling of a new technology.

Yes, there can be an illegal oil industry merger, if it is of the nature described above -- that is, anticompetitive by nature or purpose.

4. Do the current mergers benefit consumers and investors by forcing incumbent management to take all possible steps to increase efficiency and maximize the value of company assets -- lest they be taken over and replaced by other managers who believe they can do better?

Answer

Yes. Continued growth in demand can no longer be counted on to protect the inefficient. Competition will be fierce for consumer dollars and companies will be striving for greater and greater cost efficiency. Mergers are often a way of increasing cost efficiency. Furthermore, mergers reallocate resources to more valuable uses and it is obvious that some oil companies are finding the reserves of other oil companies currently undervalued. If the market is left alone, competition will sort this out.

The net result will be a more streamlined and efficient industry better able to serve the needs of future customers. Market forces act not only to weed out the inefficient but will see to it that hundreds of viable participating companies remain to compete in the U.S.

On the other hand, speculative pressure, aimed at short-run profits, threatens long-range planning and investment and is in that sense highly undesirable for the oil industry in which the major decisions are concerned with how best to invest for the future.

5. Are American consumers well served when oil companies merely buy and sell existing reserves, instead of exploring for and finding truly new supplies of oil?

Answer

In the case of Gulf's merger with Socal, the result will be increasingly effective exploration and development that will definitely benefit the consumer. Socal has committed itself to maintaining the same high level of effort as the two companies had pursued. Moreover, the combined research and development capability will enhance the prospects for finding oil in difficult and costly frontier locations.

Insofar as acquisitions have the effect of increasing the value of all oil companies' reserves, they provide an inducement to increase E&P activity. The greater the value that investors attach to company oil and gas reserves, the greater the returns from adding new such reserves and the more E&P activity it pays the industry to undertake.

6. How beneficial is the increasingly common practice of curing antitrust problems by splitting off parts of a merged company's operations -- such as its refineries of gas stations? Does it disserve consumers by creating weakened, independent competitors without secure, guaranteed access to U.S. crude?

Answer

Some spinoffs can be very beneficial, depending on the facts of the particular case. One can speculate that over the long run, non-integrated companies will have more incentive than integrated companies to bargain for the lowest-price crude and pass a part of the resultant savings along in the form of lower retail prices.

Ashland Oil, an independent with virtually no domestic production of its own, has managed to secure a larger fraction of domestic crude to run in their refineries than some of the integrated companies with significant domestic production. In general, a refinery/marketer's competitive success depends on his ability to earn a margin over market priced crude, based on his manufacturing capabilities and marketing skills, not on his "secure access" to domestic feedstocks.

In other words, spinoffs of refining and marketing operations can be an opportunity for the entrance of strong, new competitors in the marketplace as was the case with the Cities facilities purchased by Southland. As a "common practice," however, spinoffs have involved very little of the industry.

In the case of Marathon and Conoco, a spinoff was not necessary. In the case of Cities, the acquisition by Southland put the Cities refining/marketing facilities in the hands of a strong competitor which should serve consumers efficiently. In the case of Texaco/Getty, the merger plan may hasten the closing of a less efficient refinery and the retention of a more efficient refinery. On the marketing side, the Getty outlets should be a competitive independent network with a secure source of product.

All in all, there is no evidence that weakened independent competitors have been created and that the consumer is suffering negative consequences. In fact, there may be benefits to the consumer as new entrants frequently increase competition.

7. Is investment capital wastefully tied up by the tremendous credit lines used to finance these mergers? Or are the purchase funds quickly recycled through the economy, in the course of the takeover, into new investment opportunity?

Answer

No. Most of the $14 billion that is borrowed (about $12 billion after taxes) goes back into the capital markets almost immediately, so that the total supply of investment capital is not affected. In other words, banks and other capital sources still have largely the same pool of capital available for market-determined distribution to various demand sectors.

The part of reinvested funds that goes to buy stocks will make it attractive for industries to expand by issuing equity, thus reducing some need for corporate borrowing. The part that goes to bonds and other debt instruments will merely replace the amount of credit that was lost.

As the Securities and Exchange Commission recently concluded in a report on tender offers, mergers do not distort U. S. credit markets. Moreover, a large part of the cash for merger loans is coming from foreign sources. This beneficial to the U. S.

8. Have previous large oil mergers—such as U.S. Steel-Marathon, Conoco-DuPont, and Cities Service-Occidental--resulted in measurable benefits or increased efficiencies for consumers?

Answer

We only have public information at our disposal regarding these mergers. If the committee wishes to pursue this question further, we recommend that they consult the companies directly involved in these mergers.

9. Is a restructuring of the domestic oil industry desirable or inevitable? What underlying changes in the industry might force such a restructuring? Which assets are becoming more or less valuable? Why? If U.S. crude reserves are becoming increasingly concentrated by current mergers, how might that benefit or injure consumers?

Answer

Restructuring has been taking place over the entire life of the oil industry. It is inevitable, and also desirable, since it allows the industry to adjust to the changing conditions of the market.

The current restructuring reflects the industry's transition from growth to maturity. Demand has declined over the last few years and is expected to remain more or less flat in the future. There is considerable excess capacity in downstream facilities, leading to poor profitability and a decline in the value of those operations. Upstream assets (oil and gas reserves, acreage), though hurt in value by the recent decline in world crude prices, have in general become more valuable over time, since they represent proven, assured sources of future cash flow.

Using Gulf as an example, we have been in the process of restructuring for about two years. We have disposed of our unprofitable downstream operations abroad and were hard at work on a plan to reduce the Company's unprofitable operations at home. This was being accomplished either through better management or divestment. If this is what is meant by "restructuring," consumers should benefit from increase efficiencies and resultant cost savings.

10. What might be the impacts of the current merger wave on independents at all levels, i.e. producers, refiners, marketers, retailers? What are the possible impacts on employment, oil import dependency and national security?

Answer

There is not a merger wave.

Whether they are producers, refiners, marketers or retailers, there will be very little direct impact on independents. To the extent that downstream activities are spun off, or divested, the power of the independents should be increased. In response to queries, the Independent Producers Association of America indicated no concern regarding present mergers and indicated that they would testify against any legislative prohibition.

While employment will be reduced by mergers, the remaining companies will be more efficient and consequently consumers should benefit.

Regarding oil import dependency, merged firms have more financial strength. They can take more risks in frontier areas with potential for significant new discoveries. To the extent that the more efficient merged firm can find more oil, U.S. crude imports should decline.

The national security question is again answered by the more efficient surviving firm. Efficient firms strengthen our National Security; inefficient firms don't.

11. Does the takeover phenomenon contribute to more accurate oil stock valuations, and thus a more accurate and hence efficient capital market?

Answer

Yes. Takeovers contribute to more accurate pricing of oil company stock and thus more efficient capital markets. Takeovers cause corporate assets to flow to companies where the assets are most valuable. By encouraging such transfers, takeovers and mergers improve efficiency by placing assets in the most productive hands. The transfer of oil company stock to more productive hands increases the efficiency of pricing since the substantial premiums over market paid for such stock more accurately reflects the true value of the stock. In oil company mergers, for example, the high prices paid by bidders for target company stock more accurately reflect the true value of the oil and gas reserves owned by the target.

12. What could be the negative effects of a temporary ban on further large mergers? Could such a ban harm competition; protect the inefficient, incumbent management of a "target" company; or perpetuate an inflexible status quo of major firms?

Answer

Yes, it could. To quote the FTC's 1982 report on Mergers in the Petroleum Industry, "... a statutory moratorium on oil company mergers is not necessary. Such a merger ban could have an adverse effect on efficiency in the petroleum industry, discouraging the industry from exploiting opportunities for developing additional supplies of petroleum, or using existing supplies in the most efficient manner." (at p. 7)

If a moratorium were enacted, the damage to Gulf would be incalculable. We would be unable to make the investment decisions required for the long-term success of our business, and could not even carry on many day-to-day operations. Our most talented people in all likelihood would leave the company in search of more stable and satisfying employment, and the productivity of remaining employees would suffer under the weight of uncertainty. Eventually our inability to operate competitively would lead to the end of Gulf as an ongoing business and the sale of its assets for their liquidation value.

13. Is the U.S. oil industry just one part of a larger, highly competitive world oil industry? Are larger U.S. firms able to offer fiercer competition to foreign ones? Or is the international market largely a non-competitive cartel that offers little competitive threat to the large, dominant U.S. firms?

Answer

The U.S. oil industry is the most competitive by far. The world oil industry consists of OPEC and non-OPEC oil producing countries, various national oil companies, the large U.S. based integrated producers and the large foreign based international companies such as Royal Dutch Shell and British Petroleum. While OPEC controls a limited portion of this industry, the remainder is highly competitive. Rising production in the non-OPEC region has diminished OPEC's effectiveness. When reserves are found anywhere, including in the OPEC countries, it tends to put downward pressure on the price of oil, thus weakening OPEC's market power further.

The role played by larger U.S. oil companies is critical. Their size and strength are necessary to shoulder the enormous risks involved in the search to find new reserves throughout the world. This increased productive capacity restrains OPEC's market power. Furthermore in their role as refiners and marketers of crude, the larger U.S. oil companies are in a better competitive position when dealing with foreign producers. Since these U. S. companies strongly compete against each other, these favorable terms are passed on to consumers in the form of lower oil product prices.

14. How should competition advocates assess the many joint ventures typical at all levels in the oil industry, especially in exploration, leasing, production, and pipelining? When firms have their competitive fortunes interlinked with each other in so many ways by these ventures, will they really be vigorous competitors in other areas?

Answer

Competition advocates should assess oil industry joint ventures in exploration, production, leasing, pipelining, etc., as a method of lowering the cost of petroleum and related products to the consumer. Through economies (leasing), avoidance of redundancy (pipelines) and risk-sharing (exploration and production), oil industry companies are able to provide products at a lower cost than if they operated totally independent of each other. Joint venturing also provides an opportunity for smaller companies to participate in larger projects (e.g., offshore drilling). Joint venturing does not preclude vigorous competition in other industry areas.

15. How accurate is the "market concentration" theory? Are five or six large firms less likely to engage in the kind of hard competition that lowers consumer prices, than are 20 to 30 smaller ones?

Answer

The rationale behind market concentration analysis is that a limited number of companies could more easily exercise market power and make above average returns. However, economic theory would suggest that if larger firms are able to significantly increase their efficiency, then competition between five or six large, efficient firms would benefit the consumer much more than competition between 20 or 30 less efficient firms.

Without question, the oil industry in the U.S. is competitive and it is not concentrated, nor apt to become so, by any standard. For example:

-- In refining, the largest 4 companies, in 1982, had 30% of refining capacity; the largest 8 had 50%; the largest 15 had 69%. No economist can (or would) argue that these concentration ratios would indicate the pressure of monopoly power and lead to non-competitive higher prices.

-- In the upstream market, the largest 4 produced 25% of oil in 1982; the largest 8 produced 39%; the largest 15 produced 54%. Again, these concentration ratios are much too low to fear non-competitive behavior/prices.

-- For natural gas, 1982 production ratios were:

Top. 4 - 17%
Top 8 - 28%
Top 15 - 40%.

Concentration theory suggests that an industry which consists of mainly 5-6 large companies, supplying around 80% or more of the market and shielded from the effects of foreign concentration, may be less competitive than if 20-30 smaller companies constitued the industry. Since the concentration ratios in the U.S. oil industry are far lower than 80%, and the industry competes in the international crude market, there would not seem to be any real cause for concern about its competitiveness.

16. What are the implications of these mergers for natural gas consumers and pipelines?

Answer

There should be no negative impact on consumers or pipelines as a result of these mergers. Instead, a larger merged company should be in a stronger position to bid and explore more aggressively on the high risk offshore and frontier prospects, thereby assuring long-term supplies of domestic natural gas (and crude oil), ultimately benefitting consumers and pipelines. This stronger position results because a failure in one of the high risk areas is less likely to negatively influence the financial performance of the merged companies.

There are hundreds of natural gas producers in most producing areas of this country. Now more than ever, the marketplace is setting the price of natural gas, with competition coming not only from domestic producers, but also from Canadian and Mexican producers. We also have, in effect, a national natural gas pipeline grid system (much as in electricity), enabling most pipelines to purchase gas from many different regions of the country.

Also, once a pipeline company has laid a gas gathering line into a particular producing area, the pipeline company has substantial leverage over the price paid to producers wishing to tie in to that pipeline. Therefore, the negotiating advantage lies with the pipeline and not the producer — regardless of the producer's size.

17. Are the major oil companies concluding that there are fewer good prospects for finding new crude reserves in the U.S.? Does this result from Federal leasing and drilling restrictions? From a natural exhaustion of the remaining U.S. oil reserves? Or from both?

Answer

We believe most of the larger deposits are likely to be found in what is commonly referred to as the frontier areas. Most of these frontier areas are tracts owned by either the federal or state governments. These areas are quite often in hostile environments requiring large front-end expenditures that must be made several years prior to the generation of revenues. The successful exploitation of these prospects will require:

-- Large companies with good "staying power" and large cash flow generating capabilities.

-- An adequate state and federal leasing program.

-- Reasonable environmental regulations.

The number of "good" (i.e., economic) petroleum prospects in the U.S. (or elsewhere) depends on the net revenues (price less excise taxes) and cost profiles associated with exploration and production activities.

Each time a "good" discovery is made, the number of "good" prospects is reduced by one. However, there are still ample "good" petroleum prospects remaining to be discovered in the United States. According to the USGS the range of undiscovered oil resources in the U.S. is between 64 - 105 billion barrels, approximately 50% of what has already been discovered.

18. If the industry believes there are declining prospects, does this belief conflict with the FTC's judgment that more new oil reserves will be found in the U.S. in coming years? (The FTC so noted last month when it cleared the Texaco-Getty merger.)

Answer

As noted in the answer to question 17, what the industry recognizes is that there are a finite number of economic prospects to be exploited in finding more new domestic energy reserves. The USGS indicates the number of domestic reserves as yet unfound range between 64 and 105 billion barrels of oil. The industry is actively searching for and finding those reserves every day. But because those reserves will be found in frontier areas, at high risk and cost, only large firms with sufficient staying power and cash flows will be in a position to find and exploit them. Improved federal and state leasing policies and more reasonable environmental regulations will stimulate that search.

19. Will increased concentration in crude reserves lead to increased concentration in refining and marketing in future years?

Answer

No. Crude oil production and crude oil refining and marketing are almost completely unrelated aspects of the petroleum business. Crude oil today is a fungible commodity in trade. Petroleum companies sell most of their crude to third parties and buy most of their crude for refining purposes from third parties. This is the very nature of the business. There is not a direct tie between the wellhead and the gasoline pump within a company.

While there probably will be restructuring in the refining and marketing industry which will result in fewer competitors, that change will be a direct result of reduced demand for petroleum products. We are already seeing the effects of the free market in action. The number of service stations and refineries in operation today is significantly smaller than was the case in 1978. That change has nothing to do with concentration ratios for crude reserves, but rather with achieving the efficient product distribution system the free market demands.

20. Do unfriendly takeovers have different effects on competition than friendly mergers?

Answer

Yes, if the purpose of an unfriendly takeover is to liquidate the acquired company's operation. In Gulf's case, a hostile takeover by the Mesa Group would have led to a random, piecemeal break-up of Gulf without regard for the future viability of the parts of the business sold off. Such a circumstance, for instance, would eliminate Gulf's refining and marketing business as a significant source of competition in product markets. Reducing Gulf's financial strengths would prohibit Gulf's competing with other major oil industry companies in the search for new oil and gas reserves.

A friendly merger, on the other hand, improves the chances that those businesses which are required to be divested, will be treated so as to maximize their value. A healthy, well-operated group of refining and marketing properties with the capabilities to stand alone will command a higher price than could be achieved in a liquidation plan. And the competition in those markets would remain.

A merged Gulf/Socal will have the ability to search harder and longer for oil and gas reserves in frontier areas, continuing and perhaps escalating competition with other major oil companies.

TESTIMONY
OF
JAMES L. MURDY
EXECUTIVE VICE PRESIDENT
GULF CORPORATION
BEFORE
SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION
OF THE
COMMITTEE ON FINANCE
UNITED STATES SENATE

April 5, 1984

Washington, D.C.

Good morning. I'm Jim Murdy, Executive Vice President of Gulf Corporation. I appreciate this opportunity to give our views on the impact of federal tax laws on mergers. I have prepared a written statement that discusses the benefits of the Socal/Gulf merger. I request that the statement be included in the Record. For this hearing, I will focus my remarks on the tax aspects of mergers.

The Socal/Gulf merger was not driven by tax considerations. However, the circumstances that forced Gulf to seek a friendly merger with Socal were largely a result of tax considerations which Congress is already seeking to change. The tax provisions this committee recently adopted, and those adopted by the House Ways and Means Committee Amendment to H.R. 4170, would correct the tax provisions which were used by speculators over the past seven months to put Gulf in play.

Gulf sought the friendly merger with Socal because speculators had forced the market price of our stock to a level that could not be sustained by current earnings or near term prospects. Gulf was forced to realize that its survival as a strong, independent company was no longer a viable alternative.

Gulf's management faced two choices. One was a partial offer of $65 per share, by a group of speculators who planned to liquidate Gulf's assets. The other choice was a friendly merger with Socal which provided fair value at $80 per share to all of our shareholders. It also assured continued employment for most of our employees and offered maximum protection to our jobbers, dealers, suppliers and customers. Obviously, the friendly merger with Socal was the best choice. In fact, it was the only sensible choice for our shareholders, our employees and the nation.

As I mentioned, tax rules did play a major role in the speculator's attempt to take over Gulf. The promoters of that attempt got the attention of the investment community by demanding that Gulf spin-off most of its production into a royalty trust. This proposed maneuver was touted as a tax dodge to avoid the corporate tax on production.

For Gulf, it meant eventual liquidation, by taking away the cash flows necessary to maintain a strong oil company.

What really attracted speculators were the big advantages they thought they would receive in a royalty trust distribution. Those advantages derive from special dividend and capital gain and loss rules that are available only to corporations -- not to individual shareholders . Under those provisions, a corporate speculator was able to invest in a corporation before it made a royalty trust distribution and:

1. pay very small tax on the receipt of the trust distribution;

2. receive long-term capital gain treatment at a 28% rate on a sale of the trust unit; and,

3. get a deduction worth 46% from the sale of stock in the remaining corporation, since its value drops after creation of the royalty trust. (This loss can offset income which would otherwise be taxed at the 46% corporate rate.)

In essence, those tax provisions attracted speculation in Gulf stock based solely upon our liquidation value. Once short-term profiteers entered the bidding contest, our share price was driven up to a point where our merger with Socal was the only acceptable recourse.

The tax bill recently approved by the Committee on Finance will, for all practical purposes, put an end to royalty trusts by taxing the corporations that establish them. Also, the tax arbitrage play will be closed down by the proposed amendment. (It will require arbitragers to adjust their basis in the distributing corporation stock, so as to generally eliminate the ability to create a short-term capital loss.)

These changes in tax law will work in the future to make short-term profiteers look for their profits in economics rather than simply the tax consequences of takeovers.

Thank you for your attention. I will be pleased to try to answer any questions you may have.

WRITTEN SUBMISSION OF MR. JAMES L.MURDY

EXECUTIVE VICE PRESIDENT

GULF CORPORATION

before the

SUBCOMMITTEE ON ENERGY AND AGRICULTURAL TAXATION

of the

FINANCE COMMITTEE

of the

UNITED STATES SENATE

April 5, 1984

THE GULF/SOCAL MERGER
A WHITE PAPER
BY
GULF CORPORATION

The Merger

On March 5, 1984, the Standard Oil Company of California (Socal) announced its intention -- after full and in-depth negotiations with the management of Gulf Corporation (Gulf) -- to purchase all outstanding shares of Gulf's stock. Through a friendly tender offer, Socal agreed to pay $80 for each share of Gulf stock. This followed a decision in principle by Gulf's Board of Directors on February 24 to explore the possibility of a merger. The Socal cash offer of $80 per share is a strong, fair offer to all of Gulf's 260,000 shareholders.

Gulf's decision represented the best available alternative to a liquidation plan, which a minority shareholder was trying to impose on the company. Gulf's Board of Directors approved the proposed merger, recognizing that it would preserve and utilize the company's assets for their full, long term economic potential and prevent the liquidation of the company for short-term financial gain. Both companies believe that the merger will provide the maximum possible benefits to their shareholders and the nation.

Gulf's decision, and those before and after it, was guided by underlying management philosophies to which it is deeply committed. One is to protect the investment of its stockholders and to increase the value of their investment. Another is a commitment to strengthen the energy security of the nation.

The Companies

Gulf has played a central role in the petroleum industry during its 83 year history. Headquartered in Pittsburgh, Pennsylvania, Gulf markets products primarily in the eastern and southern United States. Its domestic exploration and production activities have centered in Texas and the Gulf of Mexico. Gulf's foreign producing operations currently are concentrated in West Africa and the North Sea.

Socal is a major producer, refiner and marketer of petroleum, with operations throughout the world. Headquartered in San Francisco, California, Socal markets refined products primarily in the western United States and in the Southeast. Socal's domestic exploration and production activities are concentrated in California, Louisiana, the Gulf of Mexico and the Wyoming Overthrust area. Its international activities have focused on Indonesia, Australia and the North Sea.

The merger of Socal and Gulf will result in a single company with more than $50 billion in annual sales and assets of $42 billion. For comparison, in 1983, Exxon had sales of $95 billion and Mobil Oil Corporation's sales exceeded $58 billion.

The Origins of the Merger

The energy industry experienced a tremendous economic upheaval throughout the 1970s. Dependence on insecure foreign oil, dramatically higher fuel prices, and the threat of the "oil weapon" moved Congress to enforce price and allocation controls on the petroleum industry.

Following decontrol, the return to a market-driven system for oil permitted the nation and the petroleum industry to make necessary adjustments. Higher prices spurred oil drilling rates to record levels, halting the decline in domestic production.

However, along with decontrol came the Windfall Profits Tax. Rather than permitting the industry to make full use of the cash flows a competitive market produced, those dollars were siphoned away from both increases in exploration and development, and from the returns earned by investors.

While oil decontrol is recognized as contributing to national energy security, the industry is still significantly directed by government policies. Natural gas remains controlled under the Natural Gas Policy Act. Dollars which should be earmarked for future development, such as alternate fuels, have been redirected to other projects. Severe restrictions have been placed on some of the most promising areas for exploration, especially in offshore federal lands in Florida, California, and New England.

And still, the free-market continues to operate. Decontrol permitted petroleum prices to rise to world levels. The reaction to higher prices was reduced demand. Reduced demand has forced prices back down in the world market. Increased security of supply has further reduced the risk premium for that supply. Ample supply, although a temporary phenomenon, exists in world crude markets today.

The same supply and demand forces acting on crude markets have forced price reductions in product markets. Retail margins which were never large are now miniscule or nonexistent. Refineries, distribution systems and marketing properties -- built in the days of ever-growing demand -- are being shut down or now operate at a fraction of their capacity. This rationalization of operations also includes market withdrawals, divestiture of low-profit or marginal operations, and mergers and acquisitions.

Gulf's Response to a New Market Place

During the last two years, Gulf made significant progress in its efforts to restructure itself in line with the marketplace. In 1983, it replaced over 60 percent of its U.S. production and, thanks to recent discoveries, the estimate for 1984 is a replacement rate of more than 80 percent.

Gulf also is turning around its refining and marketing business. New refining equipment now permits the processing of some of the world's cheapest crude oils, while extensive belt-tightening is improving competitiveness at the gasoline pump. Gulf also eliminated over $100 million a year of administrative and overhead costs in 1983 and sold marginal or unprofitable businesses such as European refining and marketing operations.

The Stock Market's Response to Gulf

Yet, this progress did not significantly affect Gulf's short-term profitability. These steps were chosen for their long-term effect on future Gulf operations. The redirection was based on a belief that the long-term appreciation of shareholder's value and the long-term energy security of the nation were the most important goals.

Although Gulf was making great strides, market forces and events overtook it. Gulf stock remained undervalued and the company became the target of a well-financed and aggressive group of speculators.

Speculative Attacks

The centerpiece of the speculators' plan was the formation of a royalty trust. Under their plan, Gulf would have spun off at least 50 percent of all its domestic oil and gas production. The income stream from those properties would have been diverted from Gulf to avoid corporate taxes. The revenue loss to the federal government would have been about $1 billion over the next four years and $5 billion over the life of the oil and gas reserves.

However, Gulf was not solely concerned about the impact on the Treasury Department's receipts. Rather, it was the effect such a plan would have had on its stockholders and on its long-term viability that mattered most. Because of the difference in the way that shareholders would be taxed compared to arbitrageurs and corporate holders, Gulf concluded that royalty trusts were a disservice to most of its shareholders.

If Gulf had been forced to distribute 50% of its U.S. production to its shareholders in the form of a royalty trust, there would have been an extreme difference between the tax treatment of the distribution for individual shareholders and for corporate speculators. The individuals would pay a tax based on the fair market value of the distribution, while the corporate speculator would pay a tax based on Gulf's tax basis in the distributed profits.

If you assume a royalty trust unit is worth $30.00, the individual's tax would be based on $30.00 while the corporate speculator's tax would be based on only $1.33 - Gulf's basis. Moreover, corporations are provided with a dividend received deduction of 85% which results in only taxing 15% of the $1.33 or 20 cents. In other words, on a distribution worth $30.00 the corporate speculator would pay a tax of only 46% of 20¢ or less than a dime.

The rules permitting receipt of a $30.00 dividend for less than a dime is only one of many beneficial tax rules granted the corporate speculator. When the corporate speculator sells the $30.00 trust unit, the approximately $29.00 of gain would be taxed as a capital gain. Also, the sale of the stock of a diminished Gulf would produce a short term capital loss which would have a substantial offset value to the corporate speculator.

The aggregation of all the tax benefits accorded the corporate speculators insured that, if the speculators' royalty trust liquidation plan is adopted, the corporate speculator would realize a significant after tax profit even if its original investment did not appreciate in value.

Each and every one of the preferential tax provisions which drew the corporate speculators to the Gulf situation are to be eliminated under the corporate tax reforms recently approved by the House Committee on Ways and Means and the Senate Committee on Finance. If that legislation is enacted, the royalty trust-corporate speculator scheme will be eliminated and, in the future, major corporate decisions will reflect the interests of historic individual shareholder groups rather than those of the corporate speculators.

While the royalty trust was technically not the issue of a proxy fight waged with the speculator group last year, Gulf felt that the results of that battle upheld its views on the royalty trust's inadvisability for Gulf. However, the attention generated by the battle, and a subsequent tender offer of $65.00 per share by this group for additional Gulf stock, created a frenzy on Wall Street. Gulf's stock price was forced up to a point that could not be sustained by current earnings or near term prospects.

It has become almost a cliche to say that oil can be found cheaper on Wall Street today than by drilling. Still, that fact is causing investors -- particularly institutions -- to drive up the economic rent on their positions in oil stocks. If oil stocks don't fully reflect the value of a company's underlying reserves, the financial community is demanding that corporate managements take drastic action -- even including their own liquidation -- to close that gap.

Gulf's management was compelled to recognize that Gulf's survival as an independent company was no longer a viable alternative. After weighing the alternatives, Gulf's best option was a friendly merger consistent with its philosophies of increasing stockholder value and strengthening the nation's energy security.

Why didn't Gulf erect elaborate defenses instead? In the stockholder's interest, the company decided that it could not buy out the speculators at a premium while ignoring long-term investors. From that same perspective, Gulf determined that any acquisition of another oil company simply to save Gulf's in-place management was equally unfair and inconsistent with the company's philosophies.

The Merger's Compliance with Applicable Law

Socal and Gulf will satisfy all requirements of Federal and State law regarding their merger. Socal has submitted information to the Federal Trade Commission (FTC) with respect to its tender offer and the companies will comply with all requests for information from that agency and all other Federal and state agencies.

The companies have reviewed their current operations and have determined that the merger provides an excellent fit with very little significant overlap in exploration, production, refining or marketing activities. Historically, the companies have concentrated their exploration and production activities in different areas of the world and they are currently active in distinct areas of the United States. In refining and marketing, the two companies have concentrated their activities in separate regions of the country.

Although the management and legal counsel of the two companies believe the merger has no significant anti-competitive aspects, it is anticipated that the FTC may require Socal to dispose of certain marketing and, possibly, refining assets of Gulf or Socal where there is any degree of potential concentration of operations in a particular local market. Socal and Gulf are fully prepared to comply with all reasonable requirements established by either the FTC or the Department of Justice.

In addition, Socal has initiated an internal review of the combined company's operations and may proceed to negotiate the sale of marketing assets in any local or regional area where there appears to be any potential for market concentration in excess of Federal guidelines. During the transition period, Gulf's jobbers, retail dealers, and customers will continue to have access to an adequate supply of petroleum products. All of Gulf's current supply contracts with jobbers and dealers will be honored, consistent with FTC requirements.

The Need For Large Oil Companies

It has been claimed that large companies, especially oil companies, are inherently bad solely because of their size. However, people who believe this find themselves on the other side of well-respected opinion. For example, when the New York Times commented on the Texaco-Getty merger, it said that the potential for takeovers at premium prices is a valuable incentive to look for energy resources.

This energy search requires large oil companies, like a combined Gulf/Socal, that can generate the needed investment capital, and can develop new frontier technology.

The positive technological implications of the Gulf-Socal merger should not be overlooked, especially because of the increasingly important role of technology in finding new reserves. For example, research found only at companies such as Gulf and Socal now enables the production of oil and gas from water depths that were uneconomic two or three years ago.

The synergism created as a result of the merger of Socal and Gulf research and development groups will lead to more and better research discoveries. Larger budgets will permit more ambitious research programs. The nation will enjoy the benefits of a higher level of expertise over a wider spectrum of fields. Moreover, a longer term commitment to research will be possible.

Employees

Gulf employees have been a major concern in this situation from the very start. As this merger moves forward, there will be attrition among the 42,000 people who work for Gulf. Every merger involves attrition to achieve greater productivity.

For Gulf's part, the assets of all the benefits that Gulf employees and annuitants have accrued over the years...pensions, savings plans and various others...have been secured. Severance packages for use in the event of employee terminations have been established. Socal has said that when these two companies are combined, they will draw from Gulf's excellent workforce. The merger assumes continued employment for most of Gulf's people.

TESTIMONY
OF
JAMES L. MURDY
EXECUTIVE VICE PRESIDENT
GULF CORPORATION
BEFORE
SUBCOMMITTEE ON ENERGY & MINERAL RESOURCES
OF THE
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

APRIL 10, 1984
WASHINGTON, D.C.

Good morning. I'm Jim Murdy, Executive Vice President of Gulf Corporation. Thanks for this chance to comment on the Socal/Gulf merger.

In previous testimony before the Senate Judiciary Committee and the Senate Finance Committee, we've explained the events which led the Gulf Board to find a merger partner. Rather than repeat those remarks here, I'll refer you to the records of those earlier hearings.

There were two primary concerns leading to Gulf's agreement to a friendly merger with Socal. The first was our responsibility to act in the best interests of our shareholders, employees and customers. The second -- and equally important concern -- was our responsibility to the nation and to its energy security goals.

Since energy is the key concern of this Committee, I'll take a couple of minutes to explain how the actions of the Gulf Board, in rejecting the "cash-out-now" proposals of certain dissident shareholders, were consistent with national energy goals.

During the last two years, Gulf has selected critical new directions for capital investment strategies in the U.S.

First, we are more aggressive in frontier exploration and in the research necessary to be successful in the frontiers.

Second, we stepped up the level of spending and research on enhanced recovery. This is particularly significant in our corporation, since Gulf has nearly nine billion barrels of domestic crude oil in place in depleted fields. Research breakthroughs which recover more of those reserves are going to be very important to the U.S. energy picture.

A third area of serious effort has concentrated on improving the efficiency of current production.

A fourth piece of our strategy has been to maintain our position in alternate fuels. Obviously the drop in demand and soft price forecasts have delayed a number of plans in the synfuels area. But, we have consciously made sustaining investments in resources and have kept the core technical people necessary to move back into these areas when economics make sense.

Finally, we have completed new investments in our refineries to process a wide variety of crude oil and improve operating and marketing efficiencies in a very large way. Those moves were important in improving the value of our corporation. They were also consistent with national priorities.

In those strategic areas, Gulf had quite a bit of success last year.

- We improved the quality and quantity of our frontier acreage.

- We put a drilling program in place to test several new prospects which could be extremely important to industry prospects in new exploration areas.

- We continued to build production from enhanced recovery to the point that nearly ten percent of our production today comes from those projects.

- We improved conventional production. In 1983, for the first time in more than ten years, we produced more crude oil than we did in the previous year.

- And finally our domestic exploration was the most successful in nearly a decade since we replaced seventy percent of the crude oil we produced.

When our Board looked at the success we were beginning to experience in these very important areas, they decided it was not in the interest of our shareholders to accept any of the short-term oriented, cash-out-now approaches that speculators in our stock were demanding. The Board recognized that the tremendous turnover in our shares had put speculators in a position where they stood a good chance of electing their slate of directors at our next annual meeting.

Rather than jeopardize our shareholder values and rather than waste the technical and operating gains I've just described, our Board felt the most responsible move it could make was to seek a friendly merger with a strong company -- a strong company which could get full value out of our operations and continue the important gains we had made. That's why we feel the merger with Socal makes the most sense to our shareholders, to our employees, our jobbers, our customers, and also to this country.

Thank you. I'll be pleased to answer any questions you may have.

GULF DOES NOT HAVE ANY VIABLE ALTERNATIVE TO THE MERGER WITH SOCAL

This memorandum summarizes the reasons which have led Gulf's board and management to conclude that a prompt merger with Socal is now our only viable course of action. Legislation which would impede or delay that merger would be contrary to the public interest, as well as contrary to the interests of Gulf's stockholders, employees and customers.

The Mesa Group

Last Fall, T. Boone Pickens of Mesa Petroleum and his backers secured 13.2% of the stock of Gulf Oil Corporation and waged an unsuccessful proxy contest with management. On December 29th, the Pickens Group proposed one liquidation plan for Gulf, in the form of a royalty trust spin-off of 50% of the Company's producing properties. In early February, the Group proposed another liquidation plan, involving its acquisition of control of Gulf for a bargain basement price, followed by dismemberment of the Company in order to pay off the debt incurred by the Group to finance the acquisition. A copy of that plan's summary is attached.

On February 23rd, the Mesa Group published its partial tender offer, seeking to purchase a minimum, additional block of 8% of Gulf's shares at $65 a share. It is reasonable to anticipate that if their offer succeeds, Mr. Pickens and his allies will be able to seize control of Gulf and then proceed with one or another of their liquidation plans: a large royalty trust, dismemberment, or both. For example, according to the Mesa Group plan, Gulf's exploration and production budget would have been reduced from $2 billion to $600 million annually.

Gulf's Defense

As the Mesa Group's hostile plans seemed to find support in the marketplace from short-term speculators, Gulf did what it could to combat the threat directly through communications with shareholders and the financial community, a lawsuit in the Wilmington Federal Court and strengthening its financial position. It also explored such other possible courses of action as: buying out Pickens, diluting his position by issuing new shares or exchanging shares, and making an acquisition for shares. Some of these courses were impractical; none of them could be justified in terms of management's responsibility to all shareholders.

Finally, it became clear to Gulf's Board that a friendly merger with a "White Knight" was the only alternative to some form of liquidation in which the larger number of its shareholders would be unfairly treated. After listening to several proposals, and after long and careful consideration, Gulf entered into a merger agreement with Socal and, as contemplated by that agreement, Socal made its offer to acquire all Gulf shares for $80 in cash per share. Gulf's board made that decision in order to preserve to the greatest extent possible, the Corporation's human resources and assets and to achieve fair treatment for all shareholders.

Gulf's Continuing Jeopardy:

The Mesa Group still has a partial tender offer in the market at $65 a share. If the Socal/Gulf merger is allowed to go forward, the price of Gulf shares will rise closer to the $80 price and the Mesa will not be able to buy any more shares. If the Socal/Gulf deal is stopped, or appears threatened, then the Mesa Group offer will have substance and it will be able to buy additional shares to the extent he can raise more financing. Alternatively, Mesa Group could launch a new proxy battle and obtain control without actually owning the majority of the shares of Gulf.

Conclusions:

The Mesa Group plan will remove the Gulf team from U.S. and world crude oil exploration. The Socal/Gulf merger assures that the Gulf exploration expertise will continue to be available as a unit in a company that places great emphasis on the need to continue exploring for oil and gas both in the United States and abroad. Socal and Gulf submit that this result is infinitely preferable to, and clearly better for the long range energy security of the United States than, the liquidation and dismemberment of Gulf.

VITAL STATISTICS
OF THE GULF/SOCAL MERGER

	Socal	Gulf	Combined	Industrial
Revenues* (1983)	$29.2B	$28.9B	$58.1B	N/A
(1982)	35.9	30.6	66.5	N/A
(1981)	46.6	30.5	75.7	N/A
Net Income* (1983)	1.59B	.98B		
(1982)	1.38	.90	(A)	
(1981)	2.38	1.23		
E.P.S.* (1983)	4.65	5.83	N/A	N/A
(1982)	4.03	4.98	N/A	N/A
(1981)	6.96	6.37	N/A	N/A
Capital Expenditures* (1983)	3.3B	2.8B	6.1B	
(1982)	4.7	3.7	8.4	
(1981)	5.6	4.3	9.9	
Total Assets* (1983)	24.0B	21.0B	45.0B	N/A
(1982)	23.5	20.4	43.9	N/A
(1981)	23.7	20.4	44.1	N/A
R.O.S.E.* (1983)	11.6%	9.9%	N/A	N/A
(1982)	10.6%	9.1%	N/A	N/A
(1981)	20.0%	12.5%	N/A	N/A
R.O.A.C.E.I* (1983)	8.8%	7.4%	N/A	N/A
(1982)	7.9%	6.9%	N/A	N/A
(1981)	15.2%	9.9%	N/A	N/A

(A) Combined net income would not be additive because of interest expense and possible additional book depreciation.

	SOCAL	GULF	TOTAL	INDUSTRY
Proved Reserves				
Domestic Oil (1982)**	1,202 MMB (5.2%)	816 MMB (3.5%)	2,018 MMB (8.7%)	23,175 MMB
Domestic Oil Equivalent (1982)**	2,043 MMB (4.5%)	1,466 MMB (3.2%)	3,509 MMB (7.7%)	45,308 MMB
Worldwide Oil (1982)**	(A) 1,626 MMB (4.3%)	1,968 MMB (5.2%)	3,594 MMB (9.5%)	37,648 MMB
Worldwide Oil Equivalent (1982)**	(A) 2,772 MMB (3.9%)	2,919 MMB (4.2%)	5,690 MMB (8.1%)	70,332 MMB
Domestic Natural Gas*				
(1983)	4.9 TCF	3.8 TCF	8.7 TCF	-
(1982)	5.1	3.9	9.0	-
(1981)	5.3	4.2	8.5	-
Worldwide Natural Gas*				
(1983)	6.6 TCF	5.7 TCF	12.3 TCF	-
(1982)	6.9	5.7	12.6	-
(1981)	7.2	5.9	13.1	-
Production				
Domestic & Crude & NGL				
(1983)	N/A MBD	319 MBD	N/A MBD	-
(1982)	332	329	698	-
(1981)	342	345	723	-
Worldwide Crude & NGL				
(1983)	N/A MBD	593 MBD	N/A MBD	-
(1982)	820	581	1,401	-
(1981)	921	615	1,536	-
Domestic Natural Gas				
(1983)	N/A MMCF	1,276 MMCF	N/A MMCF	-
(1982)	1,359	1,438	2,797	-
(1981)	1,412	1,685	3,097	-

(A) Does not include reserves in Indonesia held by Caltex and prohibited from disclosure by the Indonesian government.

	SOCAL	GULF	TOTAL	INDUSTRY
Production				
Worldwide Natural Gas				
(1983)	N/A MMCF	1,463 MMCF	N/A MMCF	-
(1982)	1,626	1,636	3,262	-
(1981)	1,674	1,897	3,571	-
Worldwide Refinery Input				
(1983)	1,433 MBD	939 MBD	2,372 MBD	-
(1982)	1,545	1,027	2,572	-
(1981)	1,988	1,133	3,121	-
Worldwide Petroleum Products Sold				
(1983)	1,728 MBD	1,111 MBD	2,839 MBD	-
(1982)	1,862	1,190	3,052	-
(1981)	2,173	1,194	4,224	-
Worldwide Employees (approx.)	40,000	42,700	82,700	-
U.S. Service Stations (approx.)	12,111	14,908	27,019	-

*Source: Energy Daily, 3/7/84

**Source: Oil and Gas Reserve Disclosures, 1980-1982, Arthur Anderson & Company

Mobil Oil Corporation

1100 CONNECTICUT AVENUE, N.W.
WASHINGTON, D.C. 20036

TIMOTHY A. HANAN
MANAGER, FEDERAL
GOVERNMENT RELATIONS

May 8, 1984

Dear Senator McClure:

Please accept, to be made a part of the official hearing record, the enclosed materials addressing a variety of issues involving oil mergers and acquisitions. The materials have been prepared in light of the request made at the April 10 Senate Energy and Natural Resources Subcommittee on Energy and Mineral Resources hearing for information supplementing the energy-related aspects of the merger issued addressed at the hearing as well as pertinent non-energy related aspects.

The enclosures provide a summary of our views with supplemental attachments providing additional detail on specific areas.

Please contact me or Barney Skladany if we can be of further assistance.

Sincerely,

Timothy A. Hanan

TAH:ban

Enclosures

The Honorable James A. McClure
Chairman, Committee on Energy
and Natural Resources
United States Senate
Washington, D.C. 20510

OIL MERGER AND ACQUISITION ISSUES

SUMMARY STATEMENT

1. IMPACT ON EXPLORATION AND PRODUCING

The overriding factor that will cause an increase or decrease in exploration and producing activity is whether or not individual companies and the industry as a whole has access to investment opportunities on which they can earn a profit. In part this will depend on geology. In part it will depend on the tax climate. In part it will depend on individual company's skills. Within this context, mergers and acquisitions should have a beneficial effect on exploration efficiencies. For instance, the merger of Mobil and Superior will increase the scope of geological opportunities open to the combined companies and will bring to bear technical expertise that is greater than either one now has.

2. IMPACT ON MARKETING AND REFINING OPERATIONS

Much of the testimony involving marketing and refining was concerned with the consolidation, closures and restructuring now taking place both in the United States and abroad.

These developments result from fundamental changes that are taking place in the oil industry. The sharp drop in petroleum demand combined with the increase in world oil prices has left the industry with serious overcapacity, has led consumers to seek new, lower cost ways to buy petroleum products and has left individual companies with an urgent need to cut costs if they are to survive.

In contrast to some segments of the U.S. industrial economy (which failed to adapt to changing circumstances), the American oil companies are making the necessary changes quickly, efficiently and in a totally competitive environment. What will emerge from this often painful process will be a lower-cost, more efficient marketing and refining industry.

Mergers did not cause this process to take place; rather they are a part of the free-market solution. Attempts to stop the restructuring now taking place will postpone the efficiencies being sought and add to the cost paid by the ultimate consumer.

3. FINANCE

The borrowings associated with the current mergers will neither increase interest rates nor reduce the capital available for reinvestment. The amounts are small compared to the overall credit markets and the funds paid to shareholders will be recycled back into the banking system or other investment markets.

4. TAX AND LEGAL ISSUES

In examining various tax, antitrust and security law issues, we conclude that, in general, current law and rules adequately serve the twin goals of protecting against anticompetitive actions while otherwise permitting the free market to operate with minimum distortion (assuming certain pending modifications are implemented - see Attachment D, Question 8).

In addition, we see no policy considerations which indicate that acquisitions of energy companies should be the subject of tax treatment different from that applicable to other corporate acquisitions. Adopting discriminatory rules would only make it more difficult for energy company stockholders to realize on their investment and would reduce the prices they are able to get for their stock. Similarly, mere uncertainty as to what tax rules will be applicable to energy investments for the future would also adversely affect share prices.

We also point out that the tax code has already been significantly tightened as it affects mergers by the adoption of Section 338. This section has eliminated any ability that may have previously existed to selectively step up the basis of assets of an acquired company. The effect of section 338, when combined with the recapture provisions, is to make it highly unlikely that an acquiring company will elect to step up the basis of the assets of the acquired company. These revisions mean that the acquiring company has already been stripped of tax benefits it previously might have enjoyed.

Attachments:

A. Questions & Answers on exploration and producing issues

B. Questions & Answers on marketing and refining issues

C. Questions & Answers on financial issues

D. Questions & Answers on tax and legal issues

May 4, 1984

ATTACHMENT A

EXPLORATION, PRODUCING AND ENERGY ISSUES

1. HOW WOULD MERGERS AFFECT U.S. OIL EXPLORATION AND PRODUCING?

Supporters of the various legislative proposals for temporary or permanent moratoria on mergers and acquisitions of major oil firms have argued the debt load of the acquiring company would limit the amount of exploration the company can conduct.

This opinion does not reflect business reality. The magnitude of moneys invested in any business depends upon the rewards anticipated. In the exploration for oil and natural gas, geological opportunities and the economic rewards resulting from discoveries made are the determinants of investment. The economic rewards, in turn, are directly influenced by the price received and the taxation levied.

Available evidence does not indicate that acquisitions in themselves have caused a lessening in U.S. exploration effort. To the contrary, available evidence, as reported by Senator McClure in his letter of March 27, 1984 to his Senate colleagues, pointed out that the domestic exploration and production expenditures of 6 petroleum companies involved in major acquisitions over the 1979-1982 period increased substantially after acquisition. This period followed the Iranian revolution and was

ATTACHMENT A
Question 1
(Continued)

characterized by a rapid increase in world oil prices. The acquisitions in themselves did not lead to the increase in exploration, but rather the anticipation of enhanced profitability stimulated the pace of investment. The increase in activity for these merged companies was similar to the trend for the entire domestic industry. The number of active U.S. drilling rigs (see Table 1) increased rapidly from the 2200 level in 1979 and 1980 to average nearly 4000 in 1981. Since 1981, rig activity declined in 1982 and again in 1983 to average 2232 in 1983. This decline in rig activity followed the stabilization and finally the decline in price levels in 1983, and can be attributed to the industry perception that the comfortable world crude supply outlook will limit, at least for the next several years, the extent of any possible price increases. At the same time, increases in natural gas producibility, coupled with decreases in natural gas demand, have led to the so-called "gas bubble" - the surplus of producibility over demand. In turn, the perception that new gas discoveries could not be produced at full rates for a number of years (with a resultant delay in return of capital) undoubtedly further contributed to the reduced activity. This reduced activity can in no way be attributed to past mergers.

It should be recognized the United States has received the most intensive exploration of any area in the world. There are fewer domestic prospects today and fewer larger reserve accumulations to be found. U.S. production of petroleum liquids peaked in 1972 and natural gas production peaked in 1973 (see Table 2). It is only with the large increase in drilling that occurred

ATTACHMENT A
Question 1
(Continued)

over the 1980-82 period that the decline in reserves was temporarily stabilized (Table 3). It seems unlikely there will be enough geological opportunities to permit the United States to replace all production over the longer term. Certainly, with the reduced levels of drilling now occurring, reserves will inevitably decline. The fact that the discovery of additional oil and gas reserves is becoming increasingly difficult does not, however, argue for reduced effort. To the contrary, there remains substantial undiscovered potential that makes it in all our interests to encourage rather than discourage new investment. The United States Geological Survey estimates 100 billion barrels of petroleum liquids and nearly 600 trillion cubic feet of natural gas remain to be discovered in the United States. This undiscovered potential is about three times existing proved reserves.

Future discoveries will increasingly be in very risky and expensive offshore, frontier areas or onshore areas requiring high cost deep drilling. The encouragement of drilling activity to discover and develop these new reserves requires reexamination of taxation and other disincentives that impede the ability of the oil and gas industry to seek out and develop these new sources. The so-called Windfall Profit Tax provides a particular disincentive to the exploration for oil and natural gas. This tax makes uneconomical the exploration for certain prospects and leaves oil in the ground. Moratoria on leasing offshore areas prevent the discovery of reserves in these areas. The lengthy permitting process now required increases costs in the already very

ATTACHMENT A
Question 1
(Continued)

high cost frontier areas. Finally, natural gas price controls restrict the full development of our gas potential. It is by removal of these impediments that exploration and development will be increased, not by bans on mergers.

May 4, 1984

TABLE 1

U.S. AVERAGE ANNUAL RIG ACTIVITY

	ANNUAL AVERAGE	MONTHLY	
		HIGH(1)	LOW(1)
1973	1195	1450	1000
1974	1471	1625	1350
1975	1660	1750	1550
1976	1656	1875	1450
1977	2001	2180	1850
1978	2255	2400	2100
1979	2176	2550	1900
1980	2910	3286	2571
1981	3970	4521	3386
1982	3105	4436	2402
1983	2232	2760	1646

Week of March 26, 1984 2206 active rigs

(1) Years 1973-1979 are estimated

Source: Hughes Tool Company

4/5/84

TABLE 2

U.S. Production History

	Liquids (TBD)	Gas (1) (TCF/Yr)
1960	7965	12.77
1965	9014	16.04
1970	11314	21.92
1971	11172	22.49
1972	11212*	22.53
1973	10975	22.65*
1974	10498	21.60
1975	10045	20.11
1976	9774	19.95
1977	9935	20.03
1978	10328	19.97
1979	10179	20.47
1980	10208	20.18
1981	10212	19.96
1982	10241	18.52
1983E	10240	16.58

(1) U.S. marketed wet gas

*U.S. peak production

U.S. INDUSTRY PROVED RESERVE/PRODUCTION HISTORY[7]

	LIQUIDS (MMB)						GAS (BCF)[8]					
			Additions			Production			Additions			Production
Year Ending	Proved Reserves	Adjustments	Revisions	Discoveries	Total Additions		Proved Reserves	Adjustments[4]	Revisions	Discoveries	Total Additions	
12/31/72[1]	43,125	-	859	938	1,797	(4,017)	266,085[4]	157	(1,078)	10,713	9,635	(22,512)
12/31/73	41,754	-	1,783	772	2,555	(3,926)	249,950	(354)	(3,475)	10,300	6,825	(22,606)
12/31/74	40,600	-	1,704	909	2,613	(3,767)	237,132	(179)	(1,333)	10,012	8,679	(21,318)
12/31/75	38,950	-	1,023	914	1,937	(3,587)	228,200	383	303	10,101	10,404	(19,719)
12/31/76	37,344	-	1,103	817	1,920	(3,526)	216,026	(187)	(1,197)	8,752	7,555	(19,542)
12/31/77	35,481	-	848	847	1,695	(3,558)	208,878	447	984	10,868	11,852	(19,447)
12/31/78	33,730/[5] 38,177	-	1,073	870	1,943	(3,694)	200,302/[5] 208,033	149	118	10,468	10,586	(19,311)
12/31/79[2]	36,425	401	388	1,191	1,579	(3,602)	200,997[2]	(2,264)	(219)	14,704	14,485	(19,257)
12/31/80	36,533	372	1,993	1,449	3,442	(3,706)	199,021	1,201	1,049	14,473	15,522	(18,699)
12/31/81	36,494	169	1,357	1,925	3,282	(3,490)	201,730	1,627	2,599	17,220	19,819	(18,737)
12/31/82	35,079[6]	216	413	1,627	2,040	(3,671)	201,512	2,378	455	14,455	14,910	(17,506)
• 12/31/83						(3,738)[3]						(15,899)[3]

(1) 1973-1978, API/AGA Data.
(2) 1979-1982, EIA Data.
(3) 1983, Estimate. Complete data available in Fall, 1984.
(4) 1973-1978 includes net change in storage.
(5) Upper reserve number as reported by API/AGA; lower reserve number as reported by EIA.
(6) Consists of 27,858 crude, 7,221 condensate and NGL.
(7) Peak production - liquids 4,017 MMB, 1972; gas, 22.61 TCF, 1973.
(8) Dry gas.

4/5/84

TABLE 1

ATTACHMENT A
Question 2

2. HOW WILL THE MOBIL/SUPERIOR MERGER AFFECT U.S. ENERGY SUPPLY AND SECURITY?

Proponents of anti-merger legislation have suggested mergers would be counter-productive to domestic energy/supply and security.

Mobil has and will continue to place top priority on exploration for oil and natural gas in the United States. During the past 10 years, Mobil has spent $18.7 billion on worldwide exploration and production. Of this amount, almost two-thirds, $11.9 billion, was directed domestically. Mobil expects to continue to place prime emphasis on the United States so long as prospects to drill can be found and there are incentives to do so.

Mobil believes the merger of Superior Oil with Mobil will provide a stronger combined company that will be more effective and better positioned to meet the challenge of exploring for and developing domestic energy resources. The Superior Company has a strong record in replacing domestic production. While Mobil too has had a strong record, technology in the search for oil and gas is continually expanding. Both Mobil and Superior can learn from each other. The combined company will focus the combined technology and resources to the best prospects available to both companies.

ATTACHMENT A
Question 2
(Continued)

Additionally, the combination of Mobil and Superior should, over time, permit optimization of the two staffs, thus enabling economies in supporting administrative services and creating a stronger, more efficient company. In turn, the combined company will be better positioned to compete both domestically and also in foreign countries for the discovery of oil and natural gas reserves necessary to enhance the security of the United States and the Free World.

May 4, 1984

ATTACHMENT B

MARKETING AND REFINING ISSUES

1. WON'T CONCENTRATION OF DOMESTIC CRUDE RESERVES IN THE HANDS OF A FEW REFINERS DECREASE COMPETITION BY SHUTTING DOWN MORE INDEPENDENT REFINERS?

No. Refineries are being closed because of excess refining capacity, not because of shortages of raw materials. Worldwide crude supplies have been ample and, indeed, heavily surplus all during the period of the maximum activity in refinery shutdowns. Since there have been no import restrictions on crude since 1972-73, refiners can buy crude freely in the international as well as domestic markets. Refineries, whether operated by an independent or a major, are being shut down because of overcapacity brought about by higher prices and falling demands. Although more than 3 million barrels per day of refinery capacity has been shut down over the last three years, industry refinery utilization rate is still only 73% of capacity (rate includes units idled but not permanently shut down). Tight margins and high operating costs rather than mergers or ownership of crude reserves are the key factors that will lead to the closure of additional refinery capacity. Only the most efficient refineries will remain viable over the longer term.

The above paragraph describes the general situation nationwide. There may, however, be localized circumstances where the acquisition of Company X may cause concern over the continuation of a crude supply arrangement between Company X and some local refiner (which may be owned either by an individual or by a major). Under these circumstances, the existing antitrust review

ATTACHMENT B
Question 1
(Continued)

procedures are adequate to ensure that no anticompetitive results derive from the acquisition of Company X by another company. An example of this situation occurred during the FTC review of the Mobil/Superior merger. This instance involved the supply of Superior crude to the Giant oil refinery in the Four Corners Area. Mobil is now discussing with the FTC and other interested parties terms that will adequately protect the Giant oil refinery.

May 4, 1984

ATTACHMENT B
Question 2

2. WON'T MERGERS DRIVE DOWN REFINING MARGINS AND SHUT DOWN INDEPENDENT REFINERS TO THE DETRIMENT OF THE UNBRANDED MARKET SECTOR?

No. The 3 million barrels per day of U.S. refining capacity shut down over the past 3 years has included both major and independent refiners' facilities. It is mainly a direct result of falling demands and excess capacity, not oil mergers. It is essentially the least efficient refineries that are being shut down - refineries that lack economy of scale and the more sophisticated process units required to upgrade lower value heavy fuel oil to more valuable products. Many of these refineries were built during the 1970's in response to government subsidies and survived those years only because of these subsidies.

In some cases, however, refining company problems have been related more to financial management and planning than to the configuration and size of their refineries. For example, many refineries may have been expanded and/or modernized based on what proved to be erroneous assumptions, i.e. continued federal subsidies, growth in product demands and ever increasing prices.

The U.S. and world market today is substantially different than it was in 1978-1981. Demand is down more than 20%, crude prices have dropped $5/bbl. and price controls and all the associated subsidies have been ended. These factors resulted in razor thin operating margins in the refining industry. Undercapitalized refiners or those caught in the midst of an expansion or modernization with high interest rate loans were placed under severe financial strains. Lowered credit ratings compounded their problems by forcing their

ATTACHMENT B
Question 2
(Continued)

raw materials purchases to essentially a cash basis. Although some refining companies may face bankruptcy, any modernized refineries owned by them may well survive (although possibly under new ownership).

There are a number of independent refiners that did not overexpand and who have maintained a sound financial position. Many such refiners appear to be doing well and should weather this period of surplus capacity and low margins. In any event, the problems of the refining sector (both majors and independents) occurred prior to and for reasons entirely separate from recent merger activity.

May 4, 1984

ATTACHMENT B
Question 3

3. WON'T SALES OF BRANDED DEALER STATIONS TO LARGER JOBBERS OR CHAIN MARKETERS REDUCE COMPETITION?

SIGMA, a large independent marketer association, testified before the House Small Business Committee on 4/11/84 that independent marketers and chain retailers pioneered such innovations as self-serve and high-volume/low-margin marketing concepts which minimized marketing operating costs and enabled them to offer product to the motorists at the lowest possible price. The success of this strategy is evidenced by the growth of jobbers' gasoline market share from 35.6% of the U.S. market in 1972 to 52.1% in 1981 (EIA data reported by DOE in the draft report "Deregulated Gasoline Marketing," March 1984). This growth indicates jobbers are very much a competitive sector in the marketplace and the sale of stations to this segment of the market should not reduce competition.

May 4, 1984

ATTACHMENT B
Question 4

4. SHOULDN'T BRANDED DEALER STATIONS BE PRESERVED BY LEGISLATION OR REGULATIONS BECAUSE THEY OFFER FULL SERVICE TO THE CONSUMER?

Using this type of logic, self-serve supermarkets, discount department stores and drive-in banks should be barred in favor of the clerk behind the counter of years past. The answer is no; efficiencies must be permitted. Consumer demands and preferences, driven by higher gasoline prices, have been for self-service outlets where prices, according the Lundberg Survey Inc., are generally about 15-20 cents/gallon below the average price for the same product at full service outlets. Also, the last decade has brought about the rapid expansion of franchised automotive specialty stores. These franchises created new competition for automotive services traditionally provided by the service station dealer. This factor, plus the growing consumer preference for self-service, accelerated the evolution to high volume, low margin gasoline outlets. (Self-serve outlets are estimated to have grown from 44% of gasoline outlets in 1978 to 62% by mid-year 1983.) Legislation or regulations to preserve branded dealer full service outlets could only act to reduce competition and limit dealer profitability rather than protect the consumer.

May 4, 1984

ATTACHMENT B
Question 5

5. HOW WILL MERGERS AFFECT COMPETITION BY THE INDEPENDENT DEALER SECTOR OF THE MARKET?

Mergers should strengthen each sector of competition in the service station/gasoline outlet industry. Mergers are just one way for an industry, faced with a much smaller marketplace (e.g., gasoline consumption has fallen more than 20% since 1978) to consolidate and reorganize. The emerging companies will be stronger and more efficient and each sector of their distribution systems (including their dealer network) should similarly be benefitted and strengthened.

May 4, 1984

ATTACHMENT B
Question 6

6. HOW WILL MERGERS AFFECT THE RETAIL PRICES OF GASOLINE, HEATING OIL AND OTHER PRODUCTS?

Mergers, as well as other actions by refiners and marketers to reorganize and consolidate their operations in response to lower demands, should strengthen competition and thus maintain downward pressure on prices both at the wholesale and retail level. Competition should be strengthened because each merged competitor should be more efficient than the predecessor companies.

May 4, 1984

ATTACHMENT B
Question 7

7. TO WHAT EXTENT MIGHT MERGERS AFFECT CONCENTRATION IN THE DOWNSTREAM SECTOR?

Probably very little, if at all. The Federal Trade Commission in their statement before two Subcommittees of the House Committee on Small Business on April 11, 1984 stated, " . . . that most geographic markets at the various levels of the petroleum industry were not highly concentrated; that mergers generally increased concentration levels only slightly; and that such increases did not appear to have endangered the substantial competition the Commission found to exist in most aspects of the petroleum industry." The Commission, in their statement, also recommended against any legislative ban on oil company mergers on the basis that:

> Such interference in normal market forces is unwarranted, both because there have been no significant adverse implications on the state of competition in the industry from mergers, and because mergers with significant competitive impact can be satisfactorily examined under Section 7 of the Clayton Act and the 1976 Hart-Scott-Rodino amendments to that statute.

May 4, 1984

ATTACHMENT B
Question 8

8. TO WHAT EXTENT WILL MERGERS LEAVE A GEOGRAPHIC AREA WITHOUT ADEQUATE PRODUCT DISTRIBUTION?

Market demands and economics, not mergers, are the key factors in sustaining distribution to a given market area. The greater the demand, the greater the number of and level of competition in a given market. DOE's draft report entitled "Deregulated Gasoline Marketing," released in March 1984, points out that major changes in gasoline demand brought about by higher prices, conservation and fuel economy improvements have led to major structural changes in distribution. Most marketers have had to reexamine their channels of distribution and adjust to much lower demands. The report reveals that concentration ratios of competitors were found to be higher in states with small populations and relatively small gasoline consumption. Also, that refiner/marketers were more dependent on jobbers for distribution where there were smaller product demands because the jobbers distribution costs were less. Mergers are not expected to lead to the abandonment of markets but should bring about the strengthening of those marketers who remain in an area. In low population areas, this may result in restructuring at the jobber level with perhaps fewer brands but more effective and efficient jobbers remaining.

May 4, 1984

ATTACHMENT C

FINANCIAL ISSUES

1. WILL THE FINANCING OF THESE LARGE OIL COMPANY MERGERS INCREASE INTEREST RATES OR REDUCE THE AMOUNT OF CREDIT AVAILABLE FOR BUSINESS INVESTMENT?

No. Mergers represent a transfer of ownership of existing assets and do not create a drain on savings. The selling shareholders will recycle the cash they receive into the banking system or investment markets, making it available for productive business investment. Credit is not diverted from other businesses, nor are interest rates increased as a result of the mergers.

While these mergers are large in absolute dollars, they are small relative to the total domestic and foreign credit markets. The financing of the three large recent mergers (Mobil/Superior, Socal/Gulf, Texaco/Getty) represent less than 2 percent of domestic short-term business credit outstanding. In addition, much of the acquisition costs will ultimately be financed with funds from foreign sources and from the long-term domestic markets.

Last year, the Securities and Exchange Commission Advisory Committee on Tender Offers examined the effect of mergers on the credit markets and concluded as follows:

> "On the basis of its experience and study, including a meeting with Federal Reserve Board Chairman Paul Volcker and members of his staff, the Committee has concluded that transactions involving acquisitions of control do not result in a material

ATTACHMENT C
Question 1
(Continued)

> distortion in the credit markets, do not divert investment from new plants, do not limit consumers' ability to obtain credit and do not otherwise deplete available credit. Acquisition financing generally can be expected to have little lasting impact on the cost and availability of credit to other potential borrowers. Takeover transactions fundamentally involve a transfer of assets, not the absorption of new savings, and because the sellers of stock to an acquiring firm reinvest the proceeds, the capital is made available to others."

As a result of its analysis, the committee made the following recommendations:

> ". . . no regulatory initiative should be undertaken to limit the availability of credit in such transactions, or to allocate credit among such transactions."

May 4, 1984

ATTACHMENT C
Question 2

2. IS THE USE OF DEBT FOR ACQUISITIONS DIFFERENT FROM DEBT USED FOR OTHER CORPORATE PURPOSES?

There is one difference. When debt is incurred to finance long-term investment programs, the earnings associated with these investments are generally expected to begin at some future date. When debt is incurred for an acquisition (such as Superior) that carries with it presently productive assets, the contribution to earnings is immediate. In this latter case, the new debt has less effect on reducing Corporate borrowing power than in the former.

May 4, 1984

ATTACHMENT C
Question 3

3. DOES GOVERNMENT BORROWING AFFECT THE ECONOMY DIFFERENTLY THAN LENDING FOR MERGERS?

Yes. Mergers represent a transfer of the ownership of assets. The borrowed funds are quickly redeposited with banks or otherwise invested so that the funds remain available for new investment. Government borrowing, on the other hand, diverts credit away from productive private investment, thereby distorting the credit and capital markets.

May 4, 1984

ATTACHMENT D

TAX AND LEGAL ISSUES

1. IS THE TAX DEDUCTIBILITY OF INTEREST PAYMENTS ANY MORE OF A "SUBSIDY" WHEN USED IN A MERGER SITUATION THAN IT IS IN ANY OTHER LEGITIMATE BUSINESS TRANSACTION?

So long as a tax deduction is allowed for interest paid on funds used to acquire productive assets, there is no legitimate reason to deny the deduction when the assets are acquired through a corporate or asset acquisition which might be characterized as a merger.

Also (as described previously), the changes taking place in the oil industry are related to much more fundamental factors than the deductibility of interest. In the upstream (exploration and producing) area, the incentives to merge relate to the declining economic opportunities to develop new U.S. oil and gas reserves and to the expectation that the merged company will be able to do a better, lower cost job than the two predecessor firms. In the downstream (refining and marketing) area, the changes taking place reflect the underlying economic and competitive pressures that are now forcing inefficient facilities to close and inefficient companies either to go bankrupt or seek other solutions to their difficulties. The prospect of bankruptcy has, indeed, also faced certain upstream companies in recent years as prices have fallen while U.S. tax and other levies have not been reduced commensurately.

ATTACHMENT D
Question 1
(Continued)

While it is unarguable that the deductibility of interest on debt associated with mergers makes these mergers cheaper, this is not the same thing as saying that nondeductibility would have led to continued survival of the acquired company. Among the alternatives are acquisition of the assets (with the debt deductible), acquisition of the corporation (through stock of some form) or bankruptcy of the company. It is highly likely that any of these alternatives - if required because of nondeductibility of merger interest - would be a distortion of free market economics and, consequently, more costly to all concerned - including the nation.

May 4, 1984

ATTACHMENT D
Question 2

2. WHAT WOULD BE THE EFFECT OF DISALLOWING INTEREST ON DEBT THAT IS DIRECTLY ATTRIBUTABLE TO A PORTFOLIO INVESTMENT IN STOCK?

Disallowance of a deduction for interest on debt directly attributable to a portfolio investment in stock would not have a significant impact on energy mergers. Major acquisitions are not made in the form of portfolio investments. Instead, the acquired companies are physically integrated into the acquiring companies. Such a disallowance could have a minor restraining effect by some investors which buy a minority interest in anticipation of reselling at a profit.

May 4, 1984

ATTACHMENT D
Question 3

3. DO ENERGY ACQUISITIONS RECEIVE ANY SPECIAL OR DIFFERENT TAX TREATMENT THAN ACQUISITION TRANSACTIONS IN OTHER INDUSTRIES?

The Internal Revenue Code does not provide special or different tax treatment for energy acquisitions as compared to other types of acquisitions, except that one of the tax benefit recapture provisions - the one requiring intangible drilling cost recapture - obviously applies only to oil and gas properties.

May 4, 1984

ATTACHMENT D
Question 4

4. IS IT TRUE THAT IN THE ACQUISITION OF AN OIL CORPORATION THERE IS AN ADVANTAGE TO BE GAINED (AT THE EXPENSE OF THE TREASURY) UNDER THE WINDFALL PROFITS TAX THROUGH A TRANSFER OF OIL PRODUCING PROPERTIES?

There is no Windfall Profit Tax advantage to be gained at the expense of the Treasury by a company acquiring a producing property. This is because the Internal Revenue Code does not allow an acquirer to take the purchase price of a property into account in computing the Net Income Limitation, if the effect would be to raise the Limitation to a level greater than the seller's.

May 4, 1984

ATTACHMENT D
Question 5

5. HOW DOES THE CURRENT TAXING OF THE OIL INDUSTRY, SPECIFICALLY WINDFALL PROFIT TAXES, STATE SEVERANCE TAXES, WORLDWIDE UNITARY TAXATION, AND, LIKE ALL COMPANIES, THE DOUBLE TAXATION OF PROFITS IN THE FORM OF CORPORATE INCOME TAXES AND TAXES ON THEIR SHAREHOLDERS' DIVIDENDS, AFFECT EXPLORATION ACTIVITY?

The Windfall Profit Tax (and all other taxes) are costs which burden the profit expected from new energy investments. Any cost which lowers an anticipated investment return reduces the attraction of the investment and forces investment funds into other areas. Removing the burden would have the opposite effect.

May 4, 1984

ATTACHMENT D
Question 6

6. ISN'T IT TRUE THAT EXPLORATION IN FRONTIER AREAS IS ESPECIALLY INHIBITED BY TAX POLICY?

The tax incentives offered by the Internal Revenue Code for domestic exploration and drilling are the same for frontier areas as for other areas.

This is a fact that deserves some governmental concern. It is generally accepted that many (if not all) of the large undiscovered oil and gas deposits in the United States lie in these frontier areas. Industry (and Mobil) has made major efforts to discover these reserves without, in many cases, success. Mobil, for instance, has participated in the failures of the Florida Destin Anticline, the Baltimore Canyon, the Georges Bank and, most recently, the Alaska Mukluk well. In all of these cases, industry (and Mobil) has spent large sums without return.

If it is considered, as Mobil does, that these efforts to discover the country's largest anticipated undiscovered oil reserves should continue, then perhaps it is time to reconsider some of the disincentives that now exist. Burdens such as the Windfall Profit Tax further discourage efforts such as these that are already sufficiently discouraging.

May 4, 1984

ATTACHMENT D
Question 7

7. HOW DOES THE AMOUNT OF TAXES PAID BY U.S. OIL INDUSTRY COMPARE TO THAT PAID BY NON-OIL INDUSTRIES?

There have been many studies comparing the tax burdens of the oil and non-oil industries. To present a complete picture, the Windfall Profit Tax, which applies only to the oil industry, must be added to its income tax. Adjusted in this manner, statistics compiled by the Joint Committee on Taxation and analyzed by the API show the average U.S. tax burden on U.S. income of the oil industry to range between 40% and 50% for 1980-82. This compares with rates between 20% and 30% for the non-oil industry.

May 4, 1984

ATTACHMENT D
Question 8

8. IS PRESENT SECURITIES LAW APPROPRIATE IN THIS AREA OF MERGERS AND ACQUISITIONS?

The federal securities laws deal essentially with disclosure of the material features of a transaction involving securities. Beginning with the passage of the Williams Act in 1968, the securities laws and regulations have dealt in increasing detail with acquisitions of the securities of registered companies and tender offers involving such securities. Such laws and regulations deal also with mergers, consolidations and other forms of corporate reorganization to the extent that the issuance of securities is involved or action must be taken by the shareholders of one or more registered companies.

The basic goal of federal regulation in this area has been to provide a "neutral" environment, permitting market forces to control the ultimate outcome of relevant transactions. The philosophy has been that the federal scheme of regulation should not favor one potential acquiror over another nor should it either entrench management or make management unduly vulnerable to corporate raiders.

It has been pointed out that there is one area in which, under present law, the workings of the market mechanism are inhibited by the federal regulatory scheme. This is the situation where one potential acquiror offers cash in a tender offer and another bidder prefers to offer securities requiring registration under the Securities Act of 1933. Under current practice, the registration procedure would leave the bidder offering securities at a

ATTACHMENT D
Question 8
(Continued)

significant disadvantage in timing. A cash tender offer may for practical purposes proceed immediately upon the determination by the offerer to make his offer. An offer of securities must await action of the Securities and Exchange Commission declaring a Registration Statement effective. This procedure, if accompanied by a full review of the Registration Statement, can take several weeks. Even on the most expedited basis, the procedure would normally occupy at least one week. In response to a recommendation of the Advisory Committee on Tender Offers, the Commission now has under consideration the adaptation of certain of its rules and forms (primarily Rule 415 and Form S-3) so as to eliminate or greatly minimize delay with respect to securities offerings. The Commission has formally stated that it plans to adopt appropriate changes of rule reasonably promptly. With the adoption of these changes (and other less significant modifications now under consideration), the law and rules in this area should generally achieve the objective of strict neutrality. This is, and should remain, the basic legislative and regulatory goal.

May 4, 1984

ATTACHMENT D
Question 9

9. DOES THE HERFINDAHL INDEX PROVIDE AN APPROPRIATE MEASURE OF ANTITRUST IMPLICATIONS IN THE OIL INDUSTRY?

The Herfindahl Index is an analytical tool put forward by the Federal antitrust enforcement agencies, the Antitrust Division of the Department of Justice and the Federal Trade Commission. It is intended to provide some degree of predictability as to those transactions where one or the other of those agencies may take enforcement action to prevent consummation or to require the "unwinding" of a closed transaction. The Herfindahl Index does not represent a statement of current law as enforced by the courts, nor does it inhibit enforcement action by any private party entitled to bring an action under the Federal antitrust laws.

Having noted the limited role of the Herfindahl Index as an indicator of current Federal enforcement policy, its applicability in the oil industry must nevertheless be considered. The Herfindahl Index, as was true of its predecessors, deals in large measure with the degree of concentration in a particular industry. By the measure of the Herfindahl Index, as by its predecessors, the oil industry in the United States is not a concentrated industry. The exploration and producing aspects of the business are so widely dispersed over what is a national market (indeed an international market) as to make domination by any firm, including those resulting from the three merger/acquisitions currently being debated, wholly impracticable. In terms of traditional antitrust standards, the Herfindahl Index is a most appropriate measure for the oil industry. And, on the basis of such standards, none of those transactions (after giving effect to

ATTACHMENT D
Question 9
(Continued)

contemplated divestitures) is subject to any significant legal objections. Use of the Herfindahl Index in respect of oil industry mergers would be objectionable only to those who would replace the conventional standards of antitrust enforcement with different criteria based on the concept of size rather than relying on the prevention of combinations having anticompetitive effects.

May 4, 1984

HEARINGS ON OIL MERGERS

SENATE COMMITTEE ON
ENERGY AND NATURAL RESOURCES

SUBCOMMITTEE ON ENERGY
AND MINERAL RESOURCES

APRIL 10, 1984

COMMENTS FOR THE RECORD
SUBMITTED BY TEXACO INC.

Texaco appreciates this opportunity to offer comments on the general subject of mergers within the petroleum industry and provide information on Texaco's acquisition of Getty. It is our strong belief that the Texaco-Getty merger is in the best interests of all parties involved and is in keeping with broad domestic energy and economic policy goals.

Nevertheless, certain legislative proposals now appear to be using the occasion of the Texaco-Getty merger and other pending acquisitions to try to revive failed legislative efforts of the late 1970's to limit the range of investments that major petroleum companies can make. There are no more persuasive arguments today than there were then to prohibit major oil company mergers. The previous efforts failed for very good reasons -- reasons thoroughly explored in the past legislative history by testimony of witness after witness.1/

These reasons apply equally to the proposals now being advanced. They are based on serious misconceptions about the scope and effectiveness of existing laws, about the competitive functioning of this nation's petroleum industry, and about the way free markets work to assure both competitive performance and resource development.

1/ See hearings on S. 1246 before the Subcommittee on Antitrust, Monopoly and Business Rights, Senate Committee on the Judiciary, 96th Congress, 1st Session (1979).

Legislative proposals to bar mergers in the petroleum industry reflect an outdated economic philosophy -- that "big is bad." This philosophy fails to recognize that large companies are needed if America is to be competitive in world markets, and to achieve the productivity gains and technological breakthroughs that will be essential for satisfactory economic growth in the years ahead.

The Texaco-Getty Transaction

The management of Getty Oil Company and its major stockholders had serious differences over the objectives of the company. There was no longer a question about whether Getty would continue to exist unchanged. The only question was how it might be reorganized or sold.

On January 8, 1984, Texaco Inc. and Getty announced that Texaco would acquire the Getty common stock through a tender offer and a series of contractual undertakings freely entered into between Texaco, Getty, and several major Getty shareholders. It is an amicable joinder of interests, with none of the frictions so frequently associated with mergers and acquisitions.

The Texaco-Getty merger, from its inception, was clearly in the public interest. The companies fit well together, and the merger makes made good economic sense, giving each affected interest group what each sought: for Getty shareholders, increased value for their stock; for Texaco, strengthened reserves to enhance effective competition and cash flow to support exploration and production; and for U.S. consumers, a continuation of competitive energy prices, stability of supply and continuity of management of energy reserves and delivery systems.

The merger is "neutral" from a tax standpoint as far as the two companies are affected. There is no present plan for a "step up" tax basis of the assets; a royalty trust is not planned; ordinary borrowings have been used, and there does not exist any of the problems related to royalty trusts and interest deductions dealt with during the Senate Finance Committee's recent mark-up.[2]

The Texaco-Getty merger received wide support in the press and among financial analysts, as well as favorable action by the Federal Trade Commission and the courts. Whatever competitive problems the merger may have posed were carefully addressed and resolved in the Commission's proposed consent order.

The obvious merit of the Texaco-Getty merger was quickly recognized by informed opinion leaders. The New York Times, the Washington Post (twice) and the London Economist joined with government, business, and oil industry commentators in pointing out the benefits of the Texaco-Getty joinder. (See Attachment A.)

---

[2] See Senate Committee on Finance Print 98-169, April 2, 1984.

Notwithstanding this widespread support, private suits for injunctive relief on antitrust grounds were initiated in Federal district courts in Oklahoma and Rhode Island. Allegations almost identical to those made by supporters of anti-merger legislation were raised in open court. The Texaco memoranda and the resulting court decisions (see Attachment B) illustrate that these allegations hold little merit.

Of equal significance to the review and conditional clearance which has taken place in the judicial system is the exhaustive review conducted by the Federal Trade Commission. On February 13, 1984 the Federal Trade Commission, in a 4 to 1 decision, preliminarily cleared Texaco's acquisition of Getty Oil through a consent agreement. The agreement stipulates that Texaco take certain action in order to preclude any possible violations of the Clayton and Federal Trade Commission Acts.

The Federal Trade Commission was apparently concerned that the acquisition might lessen competition in several markets:

1) The manufacture and transportation of refined light products (distillate fuel oil, aviation gasoline, gasoline, jet fuels, and kerosene) in the northeastern United States;

2) The wholesale distribution of gasoline and middle distillates (home heating oil and diesel fuel) to retailers in a number of cities and areas in the Northeast;

3) The pipeline transportation of refined light product into the state of Colorado, and;

4) The sale, pipeline transportation, and refining into petroleum products of heavy crude oil in the State of California.

To remedy the Commission's concerns, Texaco has agreed to the disposition of certain properties and other actions, subject to FTC approval, as follows:

1) Divestiture of Getty Oil's petroleum-related assets in the Northeast, including 12 New England and Middle Atlantic states. Divestiture of Texaco's Eagle Point refinery at Westville, New Jersey.

2) Divestiture of Getty's refinery in El Dorado, Kansas and the marketing and transportation activities related to the refinery in 15 states, primarily in the mid-continent.

3) Continued sales, until July, 1989, of crude oil, to certain independent California refiners.

4) Texaco's agreement to support any proposed expansion or extension, north of Maryland, of the Colonial Pipeline, in which Texaco has a 14.27% stock interest. The pipeline transports refined petroleum products from Gulf Coast refineries to the East Coast.

5) Texaco's agreement, for 10 years, not to acquire without the FTC's prior approval any interest in any assets or company engaged in the refining or wholesale distribution of gasoline and middle distillates in the Northeast, or any petroleum products pipeline in Colorado.

Only Commissioner Michael Pertschuk dissented from the Commission's action, and his dissent focused mainly on a narrow point -- whether the acquisition might adversely affect the supply of crude oil to independent refiners in California. The majority of the Commission determined that this potential problem was fully resolved by the proposed consent order's supply requirements. In its determination that the Texaco-Getty acquisition should not be delayed or denied, the FTC has thus joined courts in Delaware, Oklahoma, and Rhode Island which have also -- after hearings, arguments, and briefs -- concluded that the acquisition should not be restrained or enjoined.

The Commission published on March 7 the proposed consent order in the Federal Register which allows 60 days for interested parties to comment on the merger. (See Attachment C.) Thereafter, the Commission will provide its final opinion on the acquisition.

One important facet of the proposed Consent Order is the Commission's insistence that the divested assets be sold as "ongoing, viable" petroleum refining, transportation and marketing systems. The Commission must approve both the prospective purchaser and the terms of sale to ensure that the systems continue to operate. Once the Commission grants preliminary approval of the purchaser and the terms of sale, it must issue a public notice of its decision and give all interested parties an opportunity to comment before final approval can be granted.

It should be noted that even before the issuance of the Consent Order, Texaco announced it had entered into an agreement to transfer (subject to FTC approval) substantially all of Getty's marketing activities in the Northeastern and Middle Atlantic regions of the United States to Power Test Corporation of Plainview, New York. (See Attachment D.) The transfer, along with Texaco's guarantee of a three-year supply of petroleum products, will strengthen an existing independent competitor in the East Coast markets.

In addition, Texaco has committed to maintaining current supply relationships with Getty's marketing customers, both branded and unbranded. This commitment extends to all three former Getty refineries in the United States as long as they are owned by Texaco. (See Attachment E.)

In summary, although Getty's domestic petroleum operations are being held separate during the public comment period, Texaco has acquired the Getty stock and converted the company into a wholly-owned subsidiary. The next step is for the FTC to review the comments filed on the merger and to make its final decision on the proposed consent order. Finally, there will be an opportunity for public comment on the details of each proposed divestiture.

The Current Legislative Proposals

It is unfortunate that the recent oil company mergers should be an occasion for renewed calls to place a flat and undiscriminating legislative ban on major oil company acquisitions. Far from signalling danger of harm to the economy, the mergers illustrate the important public benefits that such acquisitions can afford.

For the shareholders of the acquired company -- shareholders including pension funds and mutual funds that aggregate the financial interests of millions of investors -- the benefit of such transactions is vital and immediate: they allow the realization of higher values for their shares.3/

3/ The scope of investments in U.S. oil companies by individuals, pension funds, mutual funds, etc., is often overlooked. For example, about 50% of all American adults have a stake in 16 large domestic oil companies. These 16 companies have 85.4 million direct and indirect shareholders. (See Attachment F.)

There are also benefits for society at large. Economists generally agree that acquisitions make a vital contribution to the use of the nation's resources. The process of competition and sale to the highest bidder means that assets will end up in the hands in which, in combination with other resources, they have the highest value, not only for the immediate firms involved but for society as a whole.

These powerful benefits of a free market in assets should be sacrificed only if it clearly appears that the market is failing to serve the nation's objectives. Neither the general competitive condition of the petroleum industry nor the acquisition of smaller oil companies by larger firms gives any indication that such market failure is occurring. Like many efforts that attempt to straightjacket the free market, the current proposals to limit major petroleum acquisitions would uselessly threaten to undercut the very goals they purport to advance. Instead of increasing incentives to develop domestic petroleum resources, they would reduce them.

The main premises of these proposals appear to be that acquisitions remove competitive checks on the industry's performance, divert capital that otherwise would be invested in domestic exploration or other beneficial purposes and generally run counter to U.S. economic interests.

An understanding of the economics of the industry flatly contradicts each of these premises.

First, the petroleum industry currently is structured competitively, and would remain so even if several acquisitions took place. The most recent available data show that even after the Texaco-Getty and other pending mergers, the top ten petroleum companies would have, among them, only about fifty percent of U.S. domestic proved reserves. The remainder is held by thousands of smaller firms. The level of concentration is far below that which even begins to suggest a possible competitive failure. In short, undue concentration is neither present now nor remotely threatened.4/

Should specific competitive problems develop, there is every reason to believe that public and private actions under the antitrust laws -- laws that prohibit incipient threats to competition -- will prevent them. This clearly has been the case with respect to Texaco-Getty, which has been subjected to searching FTC and judicial review, and with respect to other petroleum industry acquisitions, both consummated and contemplated, of the recent

---

4/ All of this presupposes that the United States is a market in itself. Experience of the last decade should demonstrate, however, that the petroleum market is worldwide. In this world market, concentration of reserve holdings is even less pronounced.

past. Nothing in the present competitive structure of the industry warrants displacing careful analysis under the antitrust laws with a flat and capricious ban on all major acquisitions.

Second, a prohibition on acquisitions of petroleum reserves by integrated oil companies is allegedly desirable because it is claimed that such companies withhold supplies from or discriminate against independent petroleum marketers. Such questions about the effects of vertical integration on independents have been raised up in the past, and have been carefully analyzed by antitrust enforcement agencies in both this and the previous administrations.5/ The agencies repeatedly have stated their uniform conclusion: there is no economic basis for any concern. Were an integrated company to attempt to drive independents from the market by withholding of crude oil or product or through discriminatory tactics, it simply would lose the independents' business to competitors. Thus, the market is competitive, with multiple sources of supply; so integrated companies have no reason to try to drive out independents, and if they were to try, they would fail. If, however, there *is* a perceived competitive problem in particular circumstances, the antitrust laws as now written provide adequate protection.

5/ *See* Testimony of William F. Baxter, Assistant Attorney General, Antitrust Division, on S. 326, "Divorcement of Motor Fuel Service Stations," Senate Committee on the Judiciary, October 21, 1981; Testimony of Richard Favretto, Acting Assistant Attorney General, Antitrust Division, on H.R.1362, "Small Business Motor Fuel Marketer Preservation Act of 1981," House Subcommittee on Energy, Environment and Safety Issues affecting Small Business, March 31, 1981; Office of Competition, Department of Energy, *Final Report; The State of Competition in Gasoline Marketing* (January 1981).

Third, the allegation that consolidations like Texaco-Getty reduce, over time, private energy research and development efforts is simply without merit.

Mergers and acquisitions do not necessarily reduce the money available for investments. Money spent on an acquisition is simply transferred to the sellers of stock who in turn cycle the funds into other investments which can include oil ventures.
More important, a larger company is often in a better position to undertake R&D than a smaller company. Small companies frequently lack the investment capital necessary to achieve technological breakthroughs. For example, the millions of dollars spent by Texaco on its Cool Water Coal Gasification project represent an investment smaller companies would find prohibitive.

An indication of the fact that bigness can aid R&D is that the top four companies in the petroleum business, while making up about 25% of petroleum industry production in 1982, were responsible for almost 45% of total research and development within the industry.

Fourth, the idea that acquisitions of existing reserves reduce investment in exploration and development fails to understand how capital markets work in a free economy. Investment in trying to find and develop new reserves depends entirely on whether the effort promises to be profitable, in light of the risks, costs of capital, and predicted prices.

Energy companies, large and small, will invest funds in exploration and development so long as profitable opportunities appear. Texaco has stated publicly that it will continue to be a very aggressive explorer and developer of U.S. oil and gas reserves. We expect, in the future, when profitable opportunities are available, to equal or exceed the level of investment of the combined companies in the exploration and development of U.S. oil and gas reserves.

This posture is simply a continuing reflection of Texaco's strong commitment to finding and producing domestic energy resources. Since the early 1970's Texaco has:

- actively engaged in high-cost, high-risk exploration of frontier areas. As examples, Texaco spent $1.9 billion in acquiring leases from the Department of Interior in off-shore waters in Alaska, California, and the Gulf of Mexico; $100 million in off-shore deep-water exploration off the Atlantic coast. In 1983, Texaco achieved a success ratio for exploratory drilling in the U.S. of 40 percent.
- dramatically escalated its worldwide capital expenditures for exploration and production. Since 1978, Texaco has doubled the annual expenditures for exploration and production which average more than $1.8 billion during the period 1982 and 1983.
- expended more than $70 million through various forms of participation in drilling ventures in 1983, with smaller,

independent, and non-affiliated oil and gas companies for U.S. exploration and production.

- acquired exploratory leases totalling some 1.6 million net acres in 1983, a 37% increase over 1982 acquisitions. This includes a 70% increase in exploration acreage in the Gulf of Mexico.

The various proposals for restrictions on mergers are based, at root, on the mistaken belief that using funds for acquisitions somehow depletes the supply of funds for exploration and development. This simply is not so, either in the aggregate or for the acquiring firm. Borrowing funds for acquisitions does not "crowd out" other investments, or reduce the aggregate availability of funds for the economy as a whole. The acquisition funds are not somehow "lost." Funds are available for reinvestment through normal market processes by those who receive them, and they will be invested in energy exploration and development if that investment seems profitable compared to alternatives.

Indeed, for the particular firms involved, an acquisition, by providing greater financial strength, may significantly enhance the ability to take the kind of financial risks that exploration often involves. Certainly, an acquisition in no way reduces the firm's incentive to make an investment if it believes that investment to be profitable.

There is, in short, no reason to believe that precluding the use of capital for domestic acquisitions would increase the capital available for exploration and development. Restrictions on acquisitions would constrict the market for reserves held by relatively small domestic firms. By barring the sale of those reserves (and of the firms that hold them) the restrictions remove purchasers that would have been able and willing to pay the highest price. Such restrictions, therefore, would directly reduce the liquidity and absolute value of reserves in the hands of smaller firms. By the same token, they would also necessarily reduce such firms' incentives to invest in new reserve development.

It has also been suggested that OPEC would benefit from oil industry mergers. This contention is based on the assumption that such mergers would reduce U.S. exploration and thereby increase the country's dependence on OPEC crude supplies. The fallacy of this assumption is fully exposed by the analysis above.

To summarize: Legislation which completely bars or places a moratorium on mergers and acquisitions within the petroleum industry would be counterproductive to a sound U.S. energy policy. As the analysis presented herein clearly demonstrates, many mergers, including Texaco-Getty, can provide important energy policy benefits. Existing laws provide more than adequate review and safeguards against mergers which are anticompetitive or otherwise not in the public interest.

Attachment A.- Articles from the *New York Times*, *Washington Post* and the *London Economist*

Attachment B - Texaco memoranda and court decisions (5 documents)

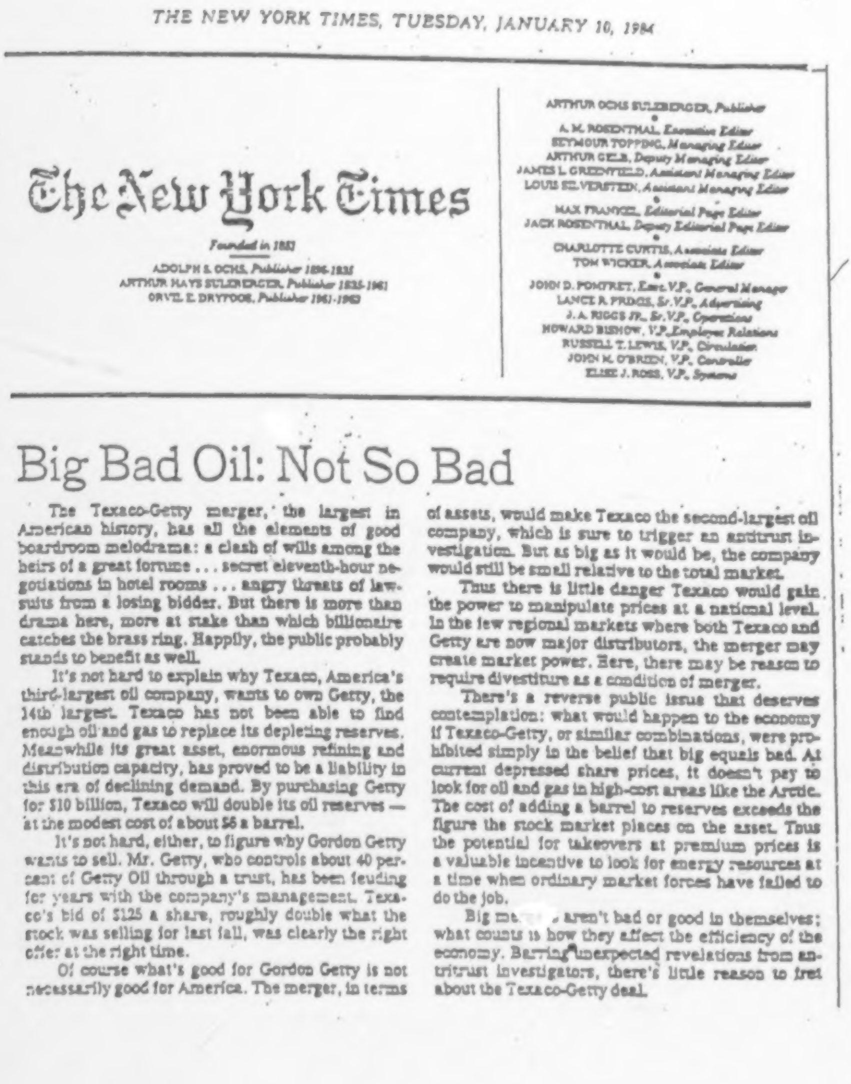
Attachment C - FTC Consent Order

Attachment D - Texaco Press Release regarding the transfer of Getty marketing activities in the Northeast and Middle Atlantic U. S. to Power Test Corp.

Attachment E - Texaco Press Release committing Texaco to continue supplying gasoline and other petroleum products at competitive prices to Getty Oil Company customers following the merger

Attachment F - API report on Direct Shareownership in Sixteen U. S. Oil Companies (Volumes I and I)

Attachment A



THE NEW YORK TIMES, TUESDAY, JANUARY 10, 1984

The New York Times

Founded in 1851

ADOLPH S. OCHS, *Publisher 1896-1935*
ARTHUR HAYS SULZBERGER, *Publisher 1935-1961*
ORVIL E. DRYFOOS, *Publisher 1961-1963*

ARTHUR OCHS SULZBERGER, *Publisher*
•
A. M. ROSENTHAL, *Executive Editor*
SEYMOUR TOPPING, *Managing Editor*
ARTHUR GELB, *Deputy Managing Editor*
JAMES L. GREENFIELD, *Assistant Managing Editor*
LOUIS SILVERSTEIN, *Assistant Managing Editor*
•
MAX FRANKEL, *Editorial Page Editor*
JACK ROSENTHAL, *Deputy Editorial Page Editor*
•
CHARLOTTE CURTIS, *Associate Editor*
TOM WICKER, *Associate Editor*
•
JOHN D. POMFRET, *Exec. V.P., General Manager*
LANCE R. PRIMIS, *Sr. V.P., Advertising*
J. A. RIGGS JR., *Sr. V.P., Operations*
HOWARD BISHOW, *V.P., Employee Relations*
RUSSELL T. LEWIS, *V.P., Circulation*
JOHN M. O'BRIEN, *V.P., Controller*
ELISE J. ROSS, *V.P., Systems*

Big Bad Oil: Not So Bad

The Texaco-Getty merger, the largest in American history, has all the elements of good boardroom melodrama: a clash of wills among the heirs of a great fortune . . . secret eleventh-hour negotiations in hotel rooms . . . angry threats of lawsuits from a losing bidder. But there is more than drama here, more at stake than which billionaire catches the brass ring. Happily, the public probably stands to benefit as well.

It's not hard to explain why Texaco, America's third-largest oil company, wants to own Getty, the 14th largest. Texaco has not been able to find enough oil and gas to replace its depleting reserves. Meanwhile its great asset, enormous refining and distribution capacity, has proved to be a liability in this era of declining demand. By purchasing Getty for $10 billion, Texaco will double its oil reserves — at the modest cost of about $6 a barrel.

It's not hard, either, to figure why Gordon Getty wants to sell. Mr. Getty, who controls about 40 percent of Getty Oil through a trust, has been feuding for years with the company's management. Texaco's bid of $125 a share, roughly double what the stock was selling for last fall, was clearly the right offer at the right time.

Of course what's good for Gordon Getty is not necessarily good for America. The merger, in terms of assets, would make Texaco the second-largest oil company, which is sure to trigger an antitrust investigation. But as big as it would be, the company would still be small relative to the total market.

Thus there is little danger Texaco would gain the power to manipulate prices at a national level. In the few regional markets where both Texaco and Getty are now major distributors, the merger may create market power. Here, there may be reason to require divestiture as a condition of merger.

There's a reverse public issue that deserves contemplation: what would happen to the economy if Texaco-Getty, or similar combinations, were prohibited simply in the belief that big equals bad. At current depressed share prices, it doesn't pay to look for oil and gas in high-cost areas like the Arctic. The cost of adding a barrel to reserves exceeds the figure the stock market places on the asset. Thus the potential for takeovers at premium prices is a valuable incentive to look for energy resources at a time when ordinary market forces have failed to do the job.

Big me[illegible] aren't bad or good in themselves; what counts is how they affect the efficiency of the economy. Barring unexpected revelations from antitrust investigators, there's little reason to fret about the Texaco-Getty deal.

THE ECONOMIST, January 14, 1984

Texaco's star turn

After its rivals' failure as conglomerates, Texaco is sensibly buying an oil company

The big surprise of the $9.9 billion proposed takeover of Getty Oil by Texaco, the largest merger ever, is that it involves two oil companies. Since Opec countries started nationalising the industry's foreign oil reserves, many big oil companies have been diversifying into businesses they know nothing about. Like magpies, they have sometimes seemed to collect everything that glitters, only to find their new pieces dulled by the time they get them back to the nest. The takeover by Texaco, the roughest and toughest of the seven sisters, makes better business sense.

Texaco's slogan was once "Number One—Second to None". Since 1979, its oil production has so outstripped its new oil finds that its reserves have fallen by more than a fifth. By buying Getty, with its better production/reserves ratio, it doubles its worldwide oil reserves, from 1.9 billion to 3.9 billion barrels. It increases the proportion of its reserves in the politically safe United States from 54% to 59%. It also jumps from third place to second place in the American oil industry's profits and assets league table, behind Exxon but ahead of Mobil.

Wiser than mines and circuses

Can it be sensible to grow bigger in an oil-glutted market? Yes, because if the deal goes through, Texaco will have acquired in a buyers' market proven oil reserves at a lower per barrel price than it now costs to find new oil. The antitrust objections that are the main obstacle to the merger do not carry conviction. The deal will boost the share of American petroleum production held by the eight biggest producers by only three percentage points—from 1982's 39% back up to the 42% they held in 1970. It will leave the top eight in petrol marketing with a combined 47% of the market, or well below the 54% they held in 1970. Though divestment of gas stations in areas where Getty and Texaco have too strong a joint market presence may be desirable, the deal promises to increase competition in most of America's oil business by restoring Texaco's oomph.

After the Opec price increases in 1973-74 presented the oil companies with immense windfall profits, many of them should in really free markets have given these windfalls back to their shareholders. The executives did not want that, so the first diversification spectacle was Gulf Oil's unsuccessful bid for Ringling Brothers, Barnum and Bailey circus.

P. T. Barnum, the circus's founder, used to say "there's a sucker born every minute". If so, Exxon should have had to find all the suckers born in a year, and persuade every one of them to invest $2,400, when it paid $1.2 billion for Reliance Electric, a company with an energy-saving electric motor. That investment was not a winner, and nor were most of the hundreds of millions of other shareholders' dollars that Exxon used to buy high-tech ventures in office equipment and so on. Mobil did little better with such low-tech diversifications as its purchase of Montgomery Ward, the department store chain, and Container Corporation of America, a paper and packaging concern.

Chastened, the oil companies were still (rightly) reluctant to drill for oil in Opec countries where governments took away their profits through nationalisation, taxes or price controls—and were eternally reluctant to slim their businesses down. So they claimed to see synergistic oportunities (ie, 2+2=5) in marrying their oil businesses with mining businesses. Both, they argued, are extractive industries. Both need corporate executives with the resources, imagination and nerve to invest in giant (and often doubtful) projects. Both require experience in negotiating with hyper-sensitive third-world governments.

Arco bought Anaconda (and has subsequently resold big bits of it at a loss). BP/Sohio bought Kennecott. Socal bought part of Amax. None of these investments has proved a success. Only part of the blame can be put on the weakening of metal prices in the 1980-82 recession. The geological skills needed for mineral mining and development are different from oil's. Oilmen have discovered that mining's labour-intensive upstream operations cannot be managed in the same way as oil's capital-intensive ones.

The takeover by Texaco of Getty should set a back-to-basics trend. As oil is found in ever deeper, icier and rougher waters, wildcat drilling is becoming a game so expensive that only the richest companies can play. The smaller companies can still make a good living from stripper wells and sniffing for leftovers in old oilfields, but medium-sized ones are vulnerable. They cannot afford the exploration effort needed to replace reserves. With their debt-free balance sheets and share prices depressed by the oil glut, many will fall prey to the biggest companies in the business, unless the trustbusters step in.

These acquisitions will not, of course, solve the long-term problem of the oil companies: that they are stuck in an industry that is on its way to liquidation because its proven reserves of a finite resource are diminishing as production continues to run ahead of new discoveries. But the seven sisters are big enough to buck this for a while, by a combination of finding new reserves through exploration and acquiring proven reserves through takeovers of the less mighty. Companies like Getty, which are not in the first division, and which have large reserves and a poor recent record of exploration, should jump at the offers. They do better by their shareholders when they accept generous take-

THE WASHINGTON POST
Saturday, January 14, 1984

Getty Soap Opera

IF YOU'RE the sort of person who spends several months trying to decide whether to replace the living room carpet, you may have been struck by the lightning speed with which the largest corporate acquisition in history was apparently consummated. For a few days there it seemed that Getty Oil Co. of Los Angeles was going to join hands with Pennzoil Co. of Houston. Over last weekend, however, Texaco Inc., once known for its stodgy approach to corporate acquisitions, persuaded the Getty management and family to dump the Pennzoil offer and sell out to Texaco for a record $9.89 billion.

To appreciate fully the difficulties that Texaco surmounted in its midnight dealings, you have to understand that Getty Oil's future was caught up in a network of intra-family/intra-corporate squabbles worthy of a prime-time series. The cast of characters was led by Gordon Getty (artist, musician and richest man in America) who controls a family trust including 40 percent of the company's stock, his reclusive older brother John Paul Getty Jr., a former SEC commissioner who heads the Getty Museum holding another sizable chunk of Getty stock, and a large supporting cast of warring relatives and Getty management officials.

In the end, money talked louder than pride. The Texaco offer is worth about $4 billion to the Getty clan, thereby nearly doubling the value of their Getty Oil holdings since last fall. In relative terms the Texaco offer wasn't worth all that much more than Pennzoil's—about $400 million—and Getty may now have to contend with rejected-suitor lawsuits promised by Pennzoil as well as the attention of federal antitrust officials that may well follow a takeover by an oil-industry giant such as Texaco.

So it's a good deal for the Getty family. What about everyone else? Once the market's initial enthusiasm dies down, Texaco stockholders, who were naturally not consulted in the hasty dealings, may suffer short-term losses from the dilution of their stock. On the other hand, Getty provides Texaco with what it very much needs—large proven oil reserves, most of which are safely located in this country. Texaco could, of course, have invested in seeking new reserves on its own—an area in which, despite recent increases in exploration, the company has lagged—but the Getty deal promises far less risk. That's why you're likely to see another round of oil company mergers in the coming months.

Concentration of oil holdings will increase, but with exploration costs steadily mounting that's not necessarily bad for the industry. And since the merger involves two companies in the same field, no loss of management skill should be expected. As for the money spent by Texaco on the acquisition, it will return to the capital markets as the Getty family and other stockholders decide how to invest their new billions. That ought to be worth watching.

2/17/84

Why Steel Mergers Differ From . . .

THE JUSTICE Department's merger ruling was a nasty surprise for the big steel companies. But as usual you would have to say that the steel industry has contributed richly to its own distress.

To the Justice Department, the steel companies argued that concentration of ownership made no difference because of the bracing discipline of foreign competition. Simultaneously the same companies were arguing at the White House, at the Capitol and in press conferences that foreign competition was killing them and had to be choked off. The companies knew that Justice was increasingly uneasy about the prospect of mergers among the biggest companies in a market already protected from its most aggressive foreign competitors. But the industry chose, in the past several weeks, to turn up the volume of its campaign for more protectionist legislation. Perhaps the result shouldn't have been such a surprise after all.

The department said that it would oppose in court, if necessary, the merger between Republic Steel and LTV's Jones and Laughlin subsidiary. By implication, that also seems to rule out the proposed merger of National into U.S. Steel. While it considered foreign competition, the department added, it had to conclude that "not all countries' imports constitute an effective check on anti-competitive abuses. . . ." How true.

The reason is that a lot of countries' steel producers are already limited by quotas on their shipments to the United States. Japan has accepted a kind of extralegal quota known euphemistically as a "voluntary restraint." When it took effect, imports from Europe soared. The Commerce Department then worked out an agreement with the European Community that extends the rules of the Western European steel cartel to the American market. With that ceiling on shipments from Europe, shipments from the Third World began to take off. The American steel industry asserts that the only real remedy is legislation that puts firm quotas on all foreign steel from all sources. But they can't have both quotas and these mergers that would increase the biggest companies' shares of a protected market. That is a fatal formula for an American steel cartel and steadily increasing steel prices.

The right solution would have been to allow the mergers but to leave the American market wide open to imports and real competition on prices. The Justice Department has chosen to oppose the mergers because, evidently, it assumes that as a matter of political reality the limits on foreign competition can only get tighter. If you accept that premise, it follows that Justice made absolutely the right decision. But it means that, despite the administration's free-market rhetoric, American policy on steel and trade is going in absolutely the wrong direction.

Oil Mergers

TWO DAYS before one federal agency denounced the steel merger, another federal agency approved a merger between two much larger oil companies. Is the federal government being inconsistent?

Not at all. It's the same rules, applied to two very different industries. The American market for steel is protected from imports. While the American market for oil used to be protected, the import controls were linked to price controls, and the domestic oil industry fought to get rid of both. It's now an open market for oil, and likely to remain that way for a very long time.

It is also true that the controlling decisions on world oil production and prices are being made by governments, not by oil companies. The companies are far richer than they were a dozen years ago. But they are also far less powerful because most of their foreign production has been nationalized. They no longer control the price of crude oil.

The question put to the Federal Trade Commission

take over the 14th-largest, Getty. The FTC decided, by four votes to one, that, yes, it's all right.

The dissenter, Michael Pertschuk, makes a point that deserves careful consideration. It is correct to say that the world oil trade is competitive, but there are many enclaves and special cases within it where the degree of competition is much less clear. Texaco wants Getty for its oil reserves. Getty has been supplying oil to some of the West Coast independent refiners, and a merger might leave those refineries unable to obtain the types of heavy oil for which they were built.

It's not necessary to get very sentimental about the West Coast refineries, many of which were built solely to exploit highly lucrative concessions lobbied into the import quota laws. The West Coast independents' contributions to effective competition have never been visible to the naked eye. But, all the same, a merger ought not be allowed to push them out of business. The FTC's majority thinks that it has written into its decision conditions sufficient to avoid that. Mr. Pert-

Attachment B

OPINION UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OKLAHOMA

Feb. 4, 1984

THE COURT: Please be seated, ladies and gentlemen.

The Court has considered the evidence, arguments of counsel, legal authorities submitted and will now rule on the issues presented by this litigation.

To begin with, the Court will address first the defendants' Motion to Dismiss Plaintiff's gasoline marketing claims.

The Court finds that the Power Test memorandum of agreement can be and should be considered by the Court in regard to possible anti-competitive effects. the authority for that is United States versus Atlantic Richfield, which states there is no reason why merging companies cannot eliminate probable anti-competitive effects by such a disposition of assets. Divestiture prior to merger is an acceptable technique to avoid an anti-trust violation. Also for the record see FTC v. Atlantic Richfield, 549 Fed. 2d 299.

Therefore, the Motion to Dismiss Plaintiff's gasoline marketing claims is granted.

We next address the issue of standing to sue. The Court must not confuse the more rigid standards for standing under Section 4 of the Clayton Act, that is 15 USC 15, suits for treble damages, with the standards for bringing suit under Section 16 for injunctive relief. Central National Bank v. Rainbolt, 720 Fed. 2d 1183, this circuit, 1983. The standing test is the complainant must prove that an anti-trust violation is the proximate cause of the threatened injury. The Court finds that Pennzoil has met that test in that it has alleged anti-competitive effects which threaten to cause it injury. Standards for preliminary injunction in this circuit, the Court refers to Lundgren versus Claytor, 619 Fed. 2d 61, 1980 case in this circuit. Both parties referred to it in their briefs and before I make reference to that Tenth Circuit decision, I want to address the specific wording of Section 16 of the Clayton Act, which states, in pertinent part, "Any person, firm, corporation, or association shall be entitled to sue for and have injunctive relief against threatened loss or damage by a violation of the anti-trust laws when and under the same conditions and principles an injunctive relief against threatened conduct that will cause damage, loss or damage is granted by the Courts of equity."

Now we address this circuit's standards for preliminary injunction, in the cited case of Lundgren versus Claytor. "In hearings," and I quote Page 63 from that decision of this circuit, "In hearings upon motions for temporary or preliminary injunctive relief, the burden is upon the one requesting such relief to make a prima facie case showing a reasonable probability that he will ultimately be entitled to the relief sought. The applicant has the additional burden of showing a right to the specific injunctive relief sought because of irreparable injury that will result if the injunction is not granted.

"This test has often been expanded into four prerequisites which the moving party must establish.

"(1) Substantial likelihood that the movant will eventually prevail on the merits;

"(2) A showing that the movant will suffer irreparable injury unless the injunction issues;

"(3) Proof that the threatened injury to the movant outweighs whatever damage the proposed injunction may cause the opposing party; and

"(4) A showing that the injunction, if issued, would not be adverse to the public's interest."

Where the movant prevails on the other factors, this Court has adopted the Second Circuit's liberal definition of the probability of success requirement, which is to justify a temporary injunction it is not necessary that the plaintiff's right to a final decision after a trial be absolutely certain, wholly without doubt, if the other elements are present, i.e. the balance of hardships tips decidedly toward plaintiff. It will ordinarily be enough that the plaintiff has raised questions going to the merits so serious, substantial, difficult and doubtful as to make them a fair ground for litigation, and thus for more deliberate investigation.

Section 16 requires Plaintiff to show a threatened loss or damage by violation of the anti-trust laws. The Court loss or damage by violation of the anti-trust laws. The Court recognizes that plaintiff need not show actual damage, but is only required to show a threat of damages. Zenith versus Hazeltine Research, Inc., authorized injunctive relief upon a showing of threatened injury, a significant threat of injury from impending violations of anti-trust laws. A threat of injury must be based upon more than conjecture and speculation. There must be some showing that there is a dangerous probability that the injury will occur. The key requirement is that the threatened injury result from the alleged anti-trust violation. Pennzoil urges the Court to consider the following relevant markets:

(1) Crude oil reserves in the United States.

(2) Oil and gas exploration in the offshore frontier areas of the United States.

(3) Crude oil production in the State of California, or alternatively petroleum allocation for Defense District 5.

After consideration of all the product and geographic markets suggested by the plaintiff, the Court has come to the following conclusion: Pennzoil has failed to show this Court that there is any likelihood that it would be able to prove at trial any injury in any relevant product or geographic market which flowed from an alleged violation of Section Seven of the Clayton Act.

I do not rule that there was no violation of Section Seven of the Clayton Act. Having found that plaintiff could not meet the test of connecting any injury to any alleged anti-competitive effect, the Court need go no further. It will not be necessary for me to address the other requirements for preliminary injunction since I find that plaintiff would not meet any standard for a showing of likelihood of success on the merits.

I emphasize again I make no comment on whether or not there would be a violation of Section Seven of the Clayton Act if the acquisition of Getty by Texaco were allowed. For the reasons set forth, I must deny the application of Pennzoil for a preliminary injunction enjoining the acquisition of Getty Oil Company by Texaco, Inc. and it is so ordered. A formal written order will be promptly entered.

I believe that concludes these proceedings. I want to comment -- yes, anything further?

MR. JEFFERS: I think, Your Honor, Mr. Greenfield, if he may address the Court for a moment.

THE COURT: Yes, Mr. Greenfield.

MR. GREENFIELD: Your Honor, this may be premature, but we have, and since I think the order is effective when dictated, we have a notice of appeal.

THE COURT: Very well.

MR. GREENFIELD: Which we would like to file with the clerk at this time.

THE COURT: You may do so.

MR. GREENFIELD: We would also like to make a motion under Rule 62(c) of the Federal Rules of Civil Procedure for an injunction during the pendency of the appeal. And I would represent to the Court that we would proceed with great expedition in bringing that appeal forward.

THE COURT: Wouldn't that be in effect accomplishing what the Court has denied here?

MR. GREENFIELD: I think not, Your Honor, because we would go to Denver Monday and try to get this thing brought on for hearing just as quickly as we could. We are talking now only about, you know, maybe about a week or so. We're talking about a situation where Texaco has said on several occasions that it may, if it can, seek to start buying stock as early as Tuesday morning. So, basically it would just maintain the status quo until at least we got to Denver and tried to obtain an expedited hearing there.

THE COURT: Let me hear from Mr. Axinn.

MR. AXINN: Your Honor, I'll buy Mr. Greenfield a ticket to Denver if he can be there Monday morning. There is no way that Texaco can purchase any shares of stock of Getty between now and then. So, if the Circuit Court is interested in entertaining his argument, if it's in a position to do so, if not it seems to me that based upon this Court's findings, I would suggest that there is no basis for the entry of this interlockatory appeal stay which, in fact, as Your Honor's question indicated, might very well result in granting precise relief which has just been denied.

THE COURT: The motion will be denied.

Anything further we can address?

MR. GREENFIELD: Would Your Honor -- we have anticipated that possibility, obviously. Would Your Honor enter an order to that effect? We have one going each way and that will put us in a position where we can go to Denver promptly.

THE COURT: Very well. If you will hand up the form. Mr. Axinn, I think, might like to review the format.

MR. AXINN: Thank you very much.

THE COURT: Being a careful man.

All right, the record will reflect the Court is entering this order: Order denying motion for an injunction pending appeal. It is hereby ordered that plaintiff Pennzoil's motion for an injunction pending appeal to the United States Court of Appeals for the Tenth Circuit of this Court's order denying plaintiff's motion for preliminary injunction dated February 4, 1984, be and is hereby denied.

And this order is being entered in open court at this time.

MR. AXINN: Thank you, Your Honor.

THE COURT: Very well. Anything further?

MR. AXINN: No, Your Honor.

THE COURT: Thank you. Gentlemen, court will be in recess.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OKLAHOMA

- - - - - - - - - - - - - - - - - - x

PENNZOIL COMPANY, :

Plaintiff, : Civil Action No. 84-C-29E

-against- : DEFENDANT TEXACO INC.'S PRETRIAL MEMORANDUM IN OPPOSITION TO PLAINTIFF'S MOTION FOR INJUNCTIVE RELIEF

TEXACO INC. and
GETTY OIL COMPANY, :

Defendants. :

- - - - - - - - - - - - - - - - - - x

Fred S. Nelson
Elizabeth Head
Kent L. Jones
HALL, ESTILL, HARDWICK, GABLE
COLLINGSWORTH & NELSON
(A Professional Corporation)
4100 Bank of Oklahoma Tower
One Williams Center
Tulsa, Oklahoma 74172
(918) 588-2700

Attorneys for Defendant Texaco Inc.

Of Counsel:

Stephen M. Axinn
C. Benjamin Crisman, Jr.
Douglas B. Adler
SKADDEN, ARPS, SLATE, MEAGHER & FLOM
919 Third Avenue
New York, New York 10022
(212) 371-6000

Milton J. Schubin
KAYE, SCHOLER, FIERMAN, HAYS & HANDLER
425 Park Avenue
New York, New York 10022
(212) 407-8000

Charles F. Kazlauskas, Jr.
TEXACO INC.
200 Westchester Avenue
White Plains, New York 10650
(914) 253-4000

Dated: January 26, 1984

TABLE OF CONTENTS

PAGE

Preliminary Statement 1

Background 2

SUMMARY OF ARGUMENT 4

ARGUMENT 5

I. PENNZOIL IS NOT AN APPROPRIATE PARTY TO MAINTAIN THE ANTITRUST CLAIMS IT ASSERTS 5

II. THE STANDARDS FOR PRELIMINARY INJUNCTIVE RELIEF 12

III. PENNZOIL CANNOT DEMONSTRATE THAT IT IS ENTITLED TO PRELIMINARY INJUNCTIVE RELIEF 15

  A. Pennzoil Cannot Demonstrate That It Is Likely To Succeed On The Merits 15

    1. Determining the relevant markets 16

    2. Determining the effect of the acquisition on competition in the relevant markets 18

    3. Pennzoil cannot establish that the acquisition may lessen competition substantially in any relevant market . 21

PAGE

(a) Pennzoil cannot demonstrate any substantial lessening of competition in exploration and production 24

(i) Exploration 24

(ii) Crude Oil Production 29

(iii) Natural Gas Production 31

(b) Pennzoil cannot demonstrate any substantial lessening of competition in the refining of crude oil 33

(c) Pennzoil cannot demonstrate any substantial lessening of competition in the transportation of crude oil in the Williston Basin and Kern Valley . . . 36

(d) Pennzoil cannot demonstrate any substantial lessening of competition in retail marketing of gasoline 38

4. Pennzoil's Speculation About Possible Future Acquisitions Is Irrelevant 40

B. Pennzoil Cannot Demonstrate That It Will Suffer Irreparable Injury Unless The Injunction Issues 42

PAGE

C. Pennzoil Cannot Demonstrate That Its Threatened Injury Outweighs The Damage An Injunction May Cause Texaco And Getty 43

D. Pennzoil Cannot Demonstrate That The Injunction, If Issued, Would Not Be Adverse To The Public Interest 44

IV. THERE IS NO REASON PENNZOIL'S MOTION FOR PRELIMINARY INJUNCTIVE RELIEF SHOULD BE CONSOLIDATED WITH THE TRIAL ON THE MERITS 45

V. THIS COURT NEED NOT REACH THE ISSUE OF THE AVAILABILITY OF DIVESTITURE IN THIS CASE 46

CONCLUSION 47

TABLE OF AUTHORITIES

CASES	PAGE
American Medicorp v. Humana, Inc., 445 F. Supp. 589 (E.D. Pa. 1977)	24, 44
Bayou Bottling, Inc. v. Dr. Pepper Co., 543 F. Supp. 1255 (W.D. La. 1982)	9
Brown Shoe Co. v. United States, 370 U.S. 294 (1962)	passim
Buffalo Forge Co. v. Ampco-Pittsburgh Corp., 638 F.2d 568 (2d Cir. 1981)	14
Central National Bank v. Rainbolt, 720 F.2d 1183 (10th Cir. 1983)	5, 7, 9
Chem-Nuclear Systems v. Waste Management, Inc., 1982-2 Trade Cas. (CCH) ¶ 64,860 (W.D. Wash. 1982)	13, 24, 43, 44
Community Communications Co. v. City of Boulder, 660 F.2d 1370 (10th Cir. 1981), *cert. dismissed*, 456 U.S. 1001 (1982)	14
Copperweld Corp. v. Imetal, 403 F. Supp. 579 (W.D. Pa. 1975)	43, 45
Drummond v. Fulton County Department of Family & Children's Services, 563 F.2d 1200 (5th Cir. 1977), *cert. denied*, 437 U.S. 910 (1978)	45
Franks v. Nimmo, 683 F.2d 1290 (10th Cir. 1982)	14, 42
Hanson v. Shell Oil Co., 541 F.2d 1352 (9th Cir. 1976), *cert. denied*, 429 U.S. 1074 (1977)	39
IT&T Corp. v. GT&E Corp., 518 F.2d 913 (9th Cir. 1975)	17, 46

CASES PAGE

Julius Nasso Concrete Corp. v. DIC Concrete Corp., 467 F.Supp. 1016 (S.D.N.Y. 1979) 46

Kenai Oil & Gas, Inc. v. Department of the Interior of the United States, 671 F.2d 383 (10th Cir. 1982) 14

Lundgrin v. Claytor, 619 F.2d 61 (10th Cir. 1980) 14

Mans v. Sunray DX Oil Co., 352 F. Supp. 1095 (N.D. Okla. 1971) 21

Mesa Petroleum Co. v. Aztec Oil & Gas Co., 406 F. Supp. 910 (N.D. Tex. 1976) 13, 44

Missouri Portland Cement Co. v. Cargill, Inc., 498 F.2d 851 (2d Cir.), cert. denied, 419 U.S. 883 (1974) 10, 13

National Indian Youth Council v. Andrus, 623 F.2d 694 (10th Cir. 1980) 14

NBO Industries Treadway Cos. v. Brunswick Corp., 523 F.2d 262 (3d Cir. 1975), rev'd on other grounds sub nom. Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477 (1977) . . 46

Pax Co. v. United States, 454 F.2d 93 (10th Cir. 1972) 14

The Pillsbury Co., 93 F.T.C. 966 (1979) 19

Proctor & Gamble Co., 63 F.T.C. 1465 (1963), rev'd, 358 F.2d 74 (6th Cir. 1966), rev'd with instructions to affirm Commission's order, 386 U.S. 568 (1967) 22

Raybestos-Manhattan, Inc. v. Hi-Shear Industries, 503 F. Supp. 1122 (E.D.N.Y. 1980) 11

Reibert v. ARCO, 471 F.2d 727 (10th Cir.), cert. denied, 411 U.S. 938 (1973) 5

CASES PAGE

SEC v. Pearson, 426 F.2d 1339 (10th Cir. 1970) 15

Singleton v. Anson County Board of Education, 387 F.2d 349 (4th Cir. 1967) 45

SKF Industries, 94 F.T.C. 6 (1979), *modified*, 96 F.T.C. 752 (1980) 19

Stanley Works v. FTC, 469 F.2d 498 (2d Cir. 1972), *cert. denied*, 412 U.S. 928 (1973) 19

Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320 (1961) 17

Telex Corp. v. IBM Corp., 367 F. Supp. 258 (N.D. Okla. 1973), *rev'd in part on other grounds*, 510 F.2d 894 (10th Cir.), *cert. dismissed*, 423 U.S. 802 (1975) 13

United States v. Alcoa, 377 U.S. 271 (1964) 19

United States v. Amax, Inc., 402 F. Supp 956 (D. Conn. 1975) 19

United States v. Bethlehem Steel Corp., 168 F. Supp. 576 (S.D.N.Y. 1958) 17

United States v. Connecticut National Bank, 362 F. Supp. 240 (D. Conn. 1973), *vacated on other grounds*, 418 U.S. 656 (1974) 40

United States v. Continental Can Co., 378 U.S. 441 (1964) 16

United States v. General Dynamics Corp., 415 U.S. 486 (1974) 21, 32, 36

United States v. Jerrold Electronics Corp., 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961) 41

CASES PAGE

United States v. Manufacturers Hanover Trust Co., 240 F. Supp. 867 (S.D.N.Y. 1965) 21, 41

United States v. Marine Bancorporation, 418 U.S. 602 (1974) 16, 20

United States v. Pennzoil Co., 252 F. Supp. 962 (W.D. Pa. 1965) 11, 20

United States v. Philadelphia National Bank, 374 U.S. 321 (1963) 18

United States v. Siemens Corp., 621 F.2d 499 (2d Cir. 1980) 15

United States v. Tracinda Investment Corp., 464 F. Supp. 660 (C.D. Cal. 1979) 11

United States v. United States Steel Corp., 251 U.S. 417 (1920) 21

Whittaker Corp. v. Edgar, 535 F. Supp. 933 (N.D. Ill. 1982) 13

Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100 (1969) 13

STATUTES AND RULES

STATUTES

15 U.S.C. § 18 . . . . 4, 5

15 U.S.C. § 18(c) 12

15 U.S.C. § 26 . . . . 12, 42

15 U.S.C. §§ 1312-19, 3375 32

49 U.S.C. §§ 1(1), 3(1) 36, 37

RULES	PAGE
Fed. R. Civ. P. 65(a)(2)	45

LEGISLATIVE MATERIALS	
S. 1916, 97th Cong., 1st Sess. (1981)	22
S. 1926, 97th Cong., 1st Sess. (1981)	22
S. 1246, 96th Cong., 1st Sess. (1979)	22
H.R. 5274, 97th Cong., 1st Sess. (1981)	22
H.R. 4748, 96th Cong., 1st Sess. (1979)	22

OTHER AUTHORITIES	
1968 Merger Guidelines of the United States Department of Justice, 2 Trade Reg. Rep. (CCH) ¶ 4510	18
1982 Merger Guidelines of the United States Department of Justice, 2 Trade Reg. Rep. (CCH) ¶ 4500	18
Advisory Committee Note, 39 F.R.D. 69 (1966)	45
American Petroleum Institute, Market Shares and Individual Company Data for U.S. Energy Markets: 1950-1982, Discussion Paper # 014R, Nov. 1983.	30
"Annual Refining Survey," Oil & Gas J. (March 21, 1983)	35
Petroleum Supply Annual, 1982 (June 1983)	30, 34

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OKLAHOMA

PENNZOIL COMPANY, Plaintiff,	:	Civil Action No. 84-C-29 E
-against-	:	DEFENDANT TEXACO INC.'S PRETRIAL MEMORANDUM IN OPPOSITION TO PLAINTIFF'S MOTION FOR INJUNCTIVE RELIEF
TEXACO INC. and GETTY OIL COMPANY, Defendants.	:	

Preliminary Statement

Defendant Texaco Inc. ("Texaco") submits this memorandum in opposition to the motion of plaintiff Pennzoil Company ("Pennzoil") for an injunction that would prohibit Texaco from acquiring the common stock of defendant Getty Oil Company ("Getty").

Regardless of whether this Court decides to consolidate Pennzoil's motion for a preliminary injunction with a trial on the merits, Pennzoil is not entitled to the extraordinary and drastic relief it seeks. This is a classic contest for corporate control. It should be decided in the forum that Congress intended -- the marketplace.

Background

On January 6, 1984, Texaco and Getty entered into a definitive merger agreement, pursuant to which Texaco has agreed to acquire all of the outstanding shares of Getty common stock at $128 per share, or an aggregate value of approximately $10.1 billion. Texaco plans to acquire 41,125,428 shares (approximately 52% of the outstanding shares) through privately negotiated agreements executed on January 6 and 8, 1984. In addition, pursuant to a cash tender offer begun on January 9, 1984, Texaco is offering to acquire up to 28 million shares (approximately 35.4% of the outstanding shares) from Getty shareholders generally. Texaco will acquire the remaining outstanding shares in a merger. Finally, Getty has granted Texaco an option to acquire 9 million authorized but unissued shares pursuant to a stock option agreement entered into between Texaco and Getty on January 6, 1984. Under applicable federal securities and antitrust laws, Texaco cannot begin to purchase Getty stock until after 11:59 p.m. (Eastern time), February 3, 1984.

In accepting Texaco's offer, the Getty board of directors unanimously rejected as not in the best interests of Getty shareholders an earlier proposal from Pennzoil to acquire a substantial minority position in Getty at a lower price than the Texaco offer. Prior to making its proposal to the Getty board, on December 28, 1983 Pennzoil commenced its own tender offer for up to 16 million shares (approximately 20.3%) of Getty common stock at $100 per share. On January 18, 1984, Pennzoil announced that if certain unlikely conditions were satisfied, it intended to amend its tender offer to purchase up to 23,406,100 shares (approximately 29.6%) of Getty stock at $125 per share.

SUMMARY OF ARGUMENT

Pennzoil seeks to enjoin Texaco's proposed acquisition of Getty stock on the ground that it will substantially lessen competition, in a grab-bag of suggested product and geographic markets, in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18 ("Section 7"). For two fundamental and independent reasons, Pennzoil's transparent attempt to gain some advantage in this contest for control of Getty should not be countenanced by this Court.

First, a spurned suitor is hardly an appropriate party to seek injunctive relief under the antitrust laws. Notwithstanding Pennzoil's speculative pleas, it suffers no antitrust injury even if the acquisition substantially lessens competition in any relevant market.

Second, Section 7 is not concerned with ephemeral possibilities. Pennzoil cannot establish the requisite probable and imminent substantial lessening of competition in any relevant market. Based on Pennzoil's own pleaded market share figures, not one purportedly relevant market is highly concentrated. Further, concentration does not increase significantly in any such market as a result of the acquisition.

ARGUMENT

I. PENNZOIL IS NOT AN APPROPRIATE PARTY TO MAINTAIN THE ANTITRUST CLAIMS IT ASSERTS

To demonstrate that it is a proper party to obtain injunctive relief in an action arising under the antitrust laws, a private plaintiff must prove that:

> the antitrust violations are the proximate cause of his injury. Two elements are necessary to demonstrate proximate cause: (1) there is a causal connection between an antitrust violation and an injury sufficient to establish the violation as a substantial factor in the occurrence of damage; and (2) that the illegal act is linked to a plaintiff engaged in activities intended to be protected by the antitrust laws.

Central National Bank v. Rainbolt, 720 F.2d 1183, 1186 (10th Cir. 1983). Accord Reibert v. ARCO, 471 F.2d 727, 731 (10th Cir.), cert. denied, 411 U.S. 938 (1973).

Applying this standard in Central National Bank, the Tenth Circuit affirmed the trial court's order denying plaintiffs' motion for a preliminary injunction, and granting defendant's motion for summary judgment, in the context of a suit brought by the target of a takeover attempt and its chairman alleging that defendant's acquisition of plaintiff-bank violated Section 7. First, the court of appeals held that the chairman had no standing to allege a Section 7 violation because any alleged injury to him -- including his ouster, lessening in the value of his stock and reduction in his borrowing ability -- was not the result of anticompetitive acts and was "too speculative in nature or too remote" from the alleged violation. 720 F.2d at 1186. The court also found that the plaintiff-bank had no standing to allege injury resulting from changes in "existing relationships" with third parties that would be caused by the acquisition because "this sort of injury is not a result of any diminution in competition but rather the effect of a change in bank control." Id. at 1187. Moreover, the court of appeals held that the bank had no standing to allege price fixing or other anticompetitive effects because it could not demonstrate that it would in fact suffer any injury: "A violation of the [Clayton] Act without resultant injury to the party bringing the claim is insufficient to confer standing." Id.

Pennzoil does not claim that it will suffer any injury as a result of the acquisition in three of the four purportedly relevant markets: refining of crude oil, transportation of crude oil and sales of gasoline. Thus, its claims with respect to these markets must be dismissed.

With respect to crude oil production, Pennzoil speculates that, by reason of Texaco's acquisition of

Getty, Pennzoil may someday have to pay more for crude oil. (Complaint ¶ 59(a), (b).) Even assuming, arguendo, that this speculation will come to pass,* similar to the plaintiff-bank in Central National Bank, Pennzoil will not suffer any injury as a result of the alleged violation. Pennzoil holds tremendous reserves in the Hueso Field of Santa Maria Basin. As Pennzoil described these reserves in its 1982 Annual Report (p. 6):

> Pennzoil has a 25-percent interest in this find, which has been termed a "giant" discovery, meaning the field contains at least 100 million barrels of oil. Estimates of the field's reserves are far higher.

Any increase in the price of crude oil will immediately increase the value of these Pennzoil reserves and others. (See Hoffman Depo. at 68 (Pennzoil intends "[t]o obtain the highest value in either price or crude oil exchange" for these reserves.)) Accordingly, Pennzoil would only benefit as a result of an increase in crude oil prices; any "injury" to Pennzoil in crude oil purchasing would be more than offset by the increased value of its crude oil reserves.*

---

* We demonstrate below (Point III) that Pennzoil could never show the probable substantial lessening of competition in crude oil sales requisite to demonstrating a Section 7 violation, much less an increase in price.

With respect to exploration, Pennzoil claims that it will be injured as a result of the acquisition since Pennzoil will find it more difficult to obtain offshore leases if Getty were unavailable as a potential partner. (Complaint ¶ 59(c).) Pennzoil has no basis for this speculative claim.** And, notwithstanding its protestations to the contrary (Supplemental Application ("Supp. App.") ¶ 18), this claim of injury is fundamentally at odds with Pennzoil's Section 7 claim that competition will lessen substantially in exploration as a result of the acquisition. If competition were to lessen substantially, Pennzoil would find it easier, not more difficult, to obtain such leases.

---

* Pennzoil contends that it is a "net purchaser" of crude oil. (Complaint ¶ 6.) While it may be true that Pennzoil purchases more crude oil than it sells, this facile contention totally ignores Pennzoil's internal consumption. It also ignores the fact that the Hueso Field will begin production within two years, at which point Pennzoil will be a net seller.

In any event, under Pennzoil's definition, Texaco is a "net purchaser" of crude oil and would continue to be after acquiring Getty. (See Texaco 1982 Annual Report at 1; Getty 1982 10-K at 4, 16.) Accordingly, Pennzoil is claiming that Texaco intends to injure itself in the crude oil market as a result of the acquisition.

** Among other things, (i) there are hundreds of potential joint venture partners besides Getty, and (ii) Texaco has been a joint venture partner of Pennzoil on numerous occasions and there is no reason to believe that the combined Texaco-Getty would not continue to be in the future. (See Point III, *infra*.)

In any event, such a claim of injury -- which could be made by Pennzoil as a result of the acquisition of Getty by any entity other than Pennzoil -- is insufficient to confer standing. As the Tenth Circuit stated in Central National Bank in rejecting the bank's claim of injury with respect to changes in "existing relationships" with third parties, "this sort of injury is not a result of any diminution of competition but rather the effect of a change in . . . control."

Finally, Pennzoil claims that if Texaco acquires Getty, Pennzoil will be unable to acquire 3/7 of Getty. Thus, Pennzoil contends that if it were to acquire Getty, it would become a "more effective competitor," (Complaint ¶ 59(d)) and would not be susceptible to being taken over. (Supp. App. ¶ 37.) These are not claims of antitrust injury. Like Pennzoil's prior claim, this alleged injury is not a result of any decreased competition, but would occur if any entity other than Pennzoil acquired Getty. See generally Bayou Bottling, Inc. v. Dr. Pepper Co., 543 F. Supp. 1255, 1265 (W.D. La. 1982) (where a third party obtained a franchise that plaintiff sought, plaintiff had no standing to allege a Section 7 violation because plaintiff's injury was "a hazard of the marketplace, and not the type of injury the antitrust laws were designed to prevent").*

As Pennzoil's last claim makes apparent, Pennzoil is bringing this case solely because it is a competing bidder for Getty stock. Although Pennzoil couches its complaint in terms of protection of a free and competitive market, its true motive is purely selfish. Pennzoil well knows that the grant of injunctive relief "spells the almost certain doom" of a tender offer. See Transcript of Conference dated January 19, 1984 ("Conference Tr.") at 25 (where Pennzoil's counsel stated "I think the ball game would be over if the injunction is granted."). See also Missouri Portland Cement Co. v. Cargill, Inc., 498 F.2d 851, 870 (2d Cir.), cert. denied, 419 U.S. 883 (1974) ("the grant of a temporary injunction on antitrust grounds spells the almost certain doom of a tender offer"); Raybestos-Manhattan, Inc. v. Hi-Shear Industries, 503 F. Supp. 1122, 1136 (E.D.N.Y. 1980); United States v. Tracinda Investment Corp., 464 F. Supp. 660, 664 (C.D. Cal. 1979).

---

* Pennzoil's argument that, as a result of the Texaco-Getty combination, it will become an attractive target for acquisition (Supp. App. ¶ 14) is utter speculation. Further, it is difficult to understand how Pennzoil can claim injury from an action which, if true, would benefit Pennzoil shareholders by increasing the return on their investment.

In its landmark decision in Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962), the Supreme Court made clear that Section 7 is concerned "with the protection of competition, not competitors . . . ." (emphasis in original). Pennzoil, with its significant private interest in the defeat of Texaco's acquisition, hardly represents the public interest that the antitrust laws were designed to protect. Pennzoil's motive in prosecuting this lawsuit is not to vindicate an antitrust claim; its true motive is improperly to influence the outcome of the contest for corporate control of Getty.

If Section 7 arguments are to be made, they should properly be made to the federal government, which has, in fact, been actively investigating the proposed acquisition since it was first announced.* Pursuant to the Hart-Scott-Rodino Antitrust Improvements Act of 1976,

---

* Pennzoil is well aware that the government antitrust enforcement agencies are capable of effectively dealing with anticompetitive acquisitions. See United States v. Pennzoil Co., 252 F. Supp. 962 (W.D. Pa. 1965).

Section 7A of the Clayton Act, 15 U.S.C. § 18(c), Congress has given the antitrust enforcement agencies both the time and the access to information necessary to assist those agencies in conducting a complete analysis of the competitive impact of an acquisition. The staff of the Federal Trade Commission ("FTC"), which has substantial experience and expertise in the petroleum industry, is now in the process of making a careful and thorough investigation of the acquisition of Getty by Texaco. Both parties have pledged to cooperate fully with the FTC staff in this investigation. The FTC is clearly a more responsible representative of the public interest than is the jilted suitor, Pennzoil.

II. THE STANDARDS FOR PRELIMINARY INJUNCTIVE RELIEF

Section 16 of the Clayton Act, 15 U.S.C. § 26, provides in pertinent part: "Any person, firm, corporation, or association shall be entitled to sue for and have injunctive relief . . . against any threatened loss or damage by a violation of the antitrust laws, when and under the same conditions and principles as injunctive relief against threatened conduct that will cause loss or damage is granted by courts of equity under the rules governing such proceedings." (emphasis added).

Thus, courts have consistently held that the standards for injunctive relief in actions arising under Section 7 are identical to those applied in other actions. See, e.g., Missouri Portland Cement Co. v. Cargill, Inc., 498 F.2d at 866-67; Chem-Nuclear Systems v. Waste Management, Inc., 1982-2 Trade Cas. (CCH) ¶ 64,860, at 72,274-75 (W.D. Wash. 1982); Whittaker Corp. v. Edgar, 535 F. Supp. 933, 944-45 (N.D. Ill. 1982); Mesa Petroleum Co. v. Aztec Oil & Gas Co., 406 F. Supp. 910, 912 (N.D. Tex. 1976). See generally Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 130 (1969) (alleged violation of Sherman Act); Telex Corp. v. IBM Corp., 367 F. Supp. 258, 355 (N.D. Okla. 1973) (Christensen, J.), rev'd in part on other grounds, 510 F.2d 894 (10th Cir.), cert. dismissed, 423 U.S. 802 (1975) (same).

The standards for obtaining a preliminary injunction are well-settled in this Circuit. To obtain such extraordinary relief, the movant carries the heavy burden of establishing each of the following:

(1) substantial likelihood that it will prevail on the merits;

(2) that it will suffer irreparable injury unless the injunction issues;

(3) that the threatened injury to it outweighs whatever damage the proposed injunction may cause the opposing party; and

(4) that the injunction, if issued, would not be adverse to the public interest.

Lundgrin v. Claytor, 619 F.2d 61, 63 (10th Cir. 1980).* Accord Kenai Oil & Gas, Inc. v. Department of the Interior of the United States, 671 F.2d 383, 385 (10th Cir. 1982); Franks v. Nimmo, 683 F.2d 1290, 1293 (10th Cir. 1982); National Indian Youth Council v. Andrus, 623 F.2d 694, 695 (10th Cir. 1980). See also Community Communications Co. v. City of Boulder, 660 F.2d 1370, 1375-76 (10th Cir. 1981), cert. dismissed, 456 U.S. 1001 (1982).

Moreover, courts have repeatedly cautioned that the movant's burden of proof is a substantial one since preliminary injunctive relief is "an extraordinary and drastic remedy which should not be routinely granted." Buffalo Forge Co. v. Ampco-Pittsburgh Corp., 638 F.2d 568, 569 (2d Cir. 1981) (quoting Medical Society of New York v. Toia, 560 F.2d 535, 538 (2d Cir. 1977)). Accord Pax Co. v. United States, 454 F.2d 93, 97 (10th Cir.

---

* If the movant's proof with respect to each of the last three elements "tips decidedly" in its favor, it may be enough that the movant "has raised questions so serious, substantial, difficult and doubtful as to make them a fair ground for litigation and thus for more deliberate investigation." Lundgrin, 619 F.2d at 63. As demonstrated below, Pennzoil cannot satisfy any one of the last three elements at all, much less show that all three tip decidedly in its favor.

1972); SEC v. Pearson, 426 F.2d 1339, 1343 (10th Cir. 1970).

These standards apply only to private plaintiffs. The government may obtain a preliminary injunction merely upon a showing that it has a reasonable likelihood of success on the merits and that the balance of equities tips in its favor. See, e.g., United States v. Siemens Corp., 621 F.2d 499, 505-06 (2d Cir. 1980).

III. PENNZOIL CANNOT DEMONSTRATE THAT IT IS ENTITLED TO PRELIMINARY INJUNCTIVE RELIEF

Even assuming that Pennzoil is an appropriate party to maintain the antitrust claims it asserts, Pennzoil cannot demonstrate that it is entitled to preliminary injunctive relief.

A. Pennzoil Cannot Demonstrate That It Is Likely To Succeed On The Merits

To succeed on its Section 7 claims, Pennzoil must first establish the relevant product and geographic markets and then prove that the effects of the proposed acquisition by Texaco would probably be "substantially to lessen competition" in those markets. See Brown Shoe Co.

v. United States, 370 U.S. 294, 317 (1962).* The Supreme Court has repeatedly warned that Section 7 is not concerned with "ephemeral possibilities," but only with the substantial loss of competition that is "probable and imminent." See id. at 323; United States v. Marine Bancorporation, 418 U.S. 602, 622-23 (1974); United States v. Continental Can Co., 378 U.S. 441, 458 (1964).

1. Determining the relevant markets

Under criteria established by the Supreme Court in Brown Shoe, the outer boundaries of a relevant product market "are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." 370 U.S. at 325. See United States v. Continental Can Co., 378 U.S. 441, 465 (1964). The Court also set forth "practical indicia" for determining the relevant market. These indicia are: "[1] industry or public recognition of the submarket as a separate economic activity, [2] the product's peculiar characteristics and uses, [3] unique production facilities, [4] distinct customers, [5] distinct prices, [6] sensitivity to price changes, and [7] specialized vendors." Brown Shoe, 370 U.S. at 321.

---

* Section 7 prohibits only those acquisitions "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

The Supreme Court did not intend that these indicia be employed in "talismanic fashion," but rather that they be used to define markets that "are 'economically significant' in terms of the alleged anticompetitive effect." IT&T Corp. v. GT&E Corp., 518 F.2d 913, 932 (9th Cir. 1975).

The relevant geographic market in which to assess the likely competitive effects of an acquisition is "the area in which the seller operates, and to which the purchaser can practicably turn for supplies." Tampa Electric Co. v. Nashville Coal Co., 365 U.S. 320, 327 (1961). However, a plaintiff may not gerrymander the geographic market so as artificially to inflate the market shares of the merging companies. United States v. Bethlehem Steel Corp., 168 F. Supp. 576, 599 (S.D.N.Y. 1958). Rather, as in the case of the relevant product market, the relevant geographic market must be defined to comport with the "commercial realities" of the industry. Brown Shoe, 370 U.S. at 336-37.

2. Determining the effect of the acquisition on competition in the relevant markets

There are two types of horizontal mergers that may have the effect proscribed by Section 7: a combination that produces a dominant firm in a concentrated market,* United States v. Philadelphia National Bank, 374 U.S. 321, 364-65 (1963) (merger created a bank having over 30% of the market in which the five-firm concentration ratio was 78% and there was a "definite trend toward concentration"), and a combination between direct competitors in a concentrated market that results in a significant increase in concentration or accelerates a significant trend toward concentration in that market. United States v. Alcoa, 377 U.S. 271, 278-81 (1964) (combined firm with 29% of a market in which the four-firm concentration ratio was 76%); Stanley Works v. FTC, 469 F.2d 498 (2d Cir. 1972), cert. denied, 412 U.S. 928 (1973). Both types of combinations may be unlawful because they may increase the probability of anti-competitive conduct. As the Supreme Court explained in United States v. Alcoa, when an acquisition significantly increases concentration in an already concentrated market, there is greater "likelihood that parallel policies of mutual advantage, not competition, will emerge." 377 U.S. at 280.

---

* The traditional case law measure of market concentration is the four-firm concentration ratio i.e., the sum of the market shares of the four largest firms. The 1968 Merger Guidelines of the U.S. Department of Justice defined a market as highly concentrated only if the four-firm concentration ratio exceeded approximately 75%. 2 Trade Reg. Rep. (CCH) ¶ 4510, at 6884.

In 1982, the Antitrust Division of the U.S. Department of Justice thoroughly revised the Merger Guidelines because it was believed that the 1968 Guidelines were too stringent. 2 Trade Reg. Rep. (CCH) ¶ 4500. The revised guidelines utilize the Herfindahl-Hirschman Index ("HHI") as the measure of market concentration. (The HHI is the sum of the squares of the market share of each market participant.) Based on the HHI, the Merger Guidelines provide certain safe harbors for acquisitions. Texaco's acquisition of Getty falls within these safe harbors in all relevant markets.

Where the market is neither highly concentrated nor characterized by a significant trend toward concentration, mergers between firms with small market shares are lawful. See, e.g., United States v. Amax, Inc., 402 F. Supp. 956, 958 (D. Conn. 1975) (upholding merger of firms with 4.6% and 1.4% shares); The Pillsbury Co., 93 F.T.C. 966 (1979) (upholding merger of firms with 14% and 2% in a market in which the four-firm concentration ratio was 61%); SKF Industries, 94 F.T.C. 6 (1979), modified, 96 F.T.C. 752 (1980) (upholding merger of firms with 8.3% and 2.2% in a market in which the four-firm concentration ratio was 66%).

Apparently recognizing that it cannot demonstrate any substantial lessening of competition resulting from Texaco's acquisition of Getty, Pennzoil makes the remarkable claim that "the traditional criteria for measuring market power -- e.g., market shares, four-firm (or eight-firm) ratios, Herfindahl indices ('HHI') -- are not meaningful measures of a merger's impact in petroleum exploration and production markets." (Supp. App. ¶ 21.) We have been unable to locate even one case in which an acquisition was enjoined under Section 7 absent analysis of these criteria. Indeed, in Brown Shoe, the Supreme Court stated that concentration ratios and market share figures are "the primary index of market power." 370 U.S. at 322 n.38 (emphasis added). And Pennzoil is well aware of the significance of market share information in the petroleum industry. See United States v. Pennzoil Co., 252 F. Supp. 962, 981 (W.D. Pa. 1965) ("Of particular importance in weighing the evidence for findings of violations under § 7 are the percentage market shares held by the companies involved.").

In addition to market share and concentration information, Section 7 analysis requires consideration of "the structure, history and probable future" of the market. Brown Shoe, 370 U.S. at 322 n.38. See, e.g., United States v. Marine Bancorporation, 418 U.S. 602 (1974) (stringent government regulation on entry and exit); United States v. General Dynamics Corp., 415 U.S. 486, 501-02 (1974) (future competitive strength properly measured by uncommitted coal reserves rather than current coal production).

3. Pennzoil cannot establish that the acquisition may lessen competition substantially in any relevant market

While both Texaco and Getty are large companies in the petroleum business, the size of an acquisition is not a determining factor under Section 7. United States v. United States Steel Corp., 251 U.S. 417, 436, 451 (1920). This Court has emphatically rejected as "unsupportable" the thesis that "mere bigness alone is a per se violation of [Section 7]." Mans v. Sunray DX Oil Co., 352 F. Supp. 1095, 1097 (N.D. Okla. 1971) (Daugherty, J.). Quoting from United States v. Manufacturers Hanover Trust Co., 240 F. Supp. 867, 929 (S.D.N.Y. 1965), Judge Daugherty wrote:

> Arguments based on size, big or little, appeal not to reason or fairness but to emotion and prejudice. The government's [plaintiff's] cries may stir resonant chimes in some ears, but they strike a gong of alarm in ours. Daily experience in the trial court teaches that such pleas generally mask a meritless case and, if anything, compel an examination of the evidence with special scrutiny and cold objectivity lest

> our oath of office become a hollow mockery and equal justice for the rich and the poor alike an empty platitude. That is no doubt the premise underlying the rule that absolute size (wealth) standing alone proves nothing violative of the antitrust laws.

Id.*

Section 7 forbids only those combinations that have an anticompetitive effect that is "significant and real, and discernible not merely to theorists or scholars but to practical, hard-headed businessmen; in a word, it must be 'substantial'". Procter & Gamble Co., 63 F.T.C. 1465, 1570 (1963), rev'd, 358 F.2d 74 (6th Cir. 1966), rev'd with instructions to affirm Commission's order, 386 U.S. 568 (1967). Although Pennzoil's Complaint and Supplemental Application dwell upon Texaco's rank in the top ten in several of the markets mentioned (e.g., Complaint ¶ 3; Supp. App. ¶ 24), that tells the Court nothing about competition in those markets. An entity does not obtain market power merely because it ranks first or second in a market. To assess the effect of an acquisition on competition, the Court must look at the economic facts in the relevant product and geographic markets and determine whether in fact and under the criteria of economics and the law the requisite substantial lessening of competition is likely to result.

---

* Moreover, Congress has periodically considered, but never enacted, legislation addressed specifically to large corporate acquisitions, including those in the petroleum industry. See, e.g., S. 1916, 97th Cong. 1st Sess. (1981); S. 1926, 97th Cong., 1st Sess. (1981); S. 1246, 96th Cong., 1st Sess. (1979); H.R. 5274, 97th Cong., 1st Sess. (1981); H.R. 4748, 96th Cong., 1st Sess. (1979). The rejection of such legislation indicates the clear congressional intent not to prohibit mergers on the basis of their size.

Applying that standard to this case, the evidence is that neither Texaco nor Getty possesses more than a small share of any of the markets in which they compete. Moreover, the petroleum business is one that is growing less "concentrated," i.e., the share of the business done by the largest firms has fallen steadily in recent years as a result of investment and competition by smaller companies, some of which are out-producing or out-marketing traditional leaders. Based on the market share figures asserted by Pennzoil, not one purportedly relevant market is highly concentrated, and concentration would not increase significantly in any such market as a result of the acquisition. In these circumstances, the acquisition will not substantially lessen competition and should therefore be permitted.

Based on Pennzoil's Supplemental Application, it appears that Pennzoil is alleging a violation of Section 7 in four purported markets: (a) exploration and production (Supp. App. ¶¶ 4-25); (b) refining of crude oil (Supp. App. ¶¶ 32-34); (c) transportation of crude oil in the Williston Basin and in the "Kern Valley" (Supp. App. ¶ 35); and (d) sales of gasoline (Supp. App. ¶¶ 26-31).

We demonstrate below that Pennzoil cannot demonstrate a probability of success on the merits of its claims with respect to any of these purported markets.

(a) Pennzoil cannot demonstrate any substantial lessening of competition in exploration and production

(i) Exploration

Pennzoil claims that it will be injured in its ability to obtain oil and gas leases on the Outer Continental Shelf of the United States if the proposed acquisition is not enjoined. It is not at all clear, however, that bidding for tract leases in the offshore United States constitutes a relevant market for Section 7 purposes. The search for crude oil and natural gas by domestic companies is conducted both onshore and offshore, both in the United States and in foreign countries. See generally Chem-Nuclear Systems v. Waste Management, Inc., 1982-2 Trade Cas. (CCH) ¶ 64,860, at 72,276 (W.D. Wash. 1982) ("looking for [hazardous chemical waste disposal] sites" does not constitute a relevant market); American

Medicorp v. Humana, Inc., 445 F. Supp. 589, 605 (E.D. Pa. 1977) (development of hospitals is not a line of commerce distinct from the provision of hospital services).

Even assuming, arguendo, that the acquisition of offshore leases constitutes a relevant market, Pennzoil cannot demonstrate the requisite substantial lessening of competition there. Pennzoil disingenuously attempts to paint a picture of a dozen or so companies controlling the exploration for offshore oil and gas resources. (Supp. App. ¶ 7.) Nothing could be further from the truth. There are generally hundreds of companies, both foreign and domestic, that are qualified to bid for each offshore lease tract. And these companies do bid. For example, in last year's lease auctions for tracts in the Central and Western Gulf of Mexico, between 70 and 100 companies submitted a total of 1788 bids, in 160 different combinations of companies.

The present administration's offshore leasing practices have been changed in such a way as to promote greater joint bidding. Rather than open bidding on just a few tracts of land at a time and allowing a company to concentrate bids on select tracts, the Reagan Administration has opened up vast areas of the Outer Continental Shelf to bids, thereby forcing all companies to spread their bids around. No company, no matter what its wealth, can afford consistently to bid alone under the current situation or even to evaluate by itself the millions of acres that are offered. Even those companies, such as Exxon, that had traditionally bid alone are now joining bidding groups to ensure representation in as many areas as possible.* Thus, if Texaco acquires Getty, Pennzoil is unlikely to have any problem obtaining partners to bid on offshore leases in the future.** In fact, with Getty unavailable as a partner to certain bidders,*** Pennzoil will become more attractive as a potential partner in situations where previously Getty may have been the preferred joint bidder. Contrary to Pennzoil's claim, Texaco neither intends nor is likely to cut back on its joint bidding after the acquisition.

---

* For example, Exxon bid on 28 tracts in the recent January 4, 1984 offshore auctions in the Eastern Gulf of Mexico "frontier region." Of these 28 bids, Exxon bid jointly with various combinations of other companies on 26. And it is impossible to tell whether Exxon sought, without success, to obtain partners for the remaining two tracts where it was the sole bidder.

** In just the five most recent Outer Continental Shelf lease sales in which Pennzoil and Getty participated, Pennzoil entered into twenty-five joint ventures or partnerships for bids and had 16 different partners, including, among others: Amoco, Chevron, Conoco, Exxon, Getty, Gulf, Murphy, Odeco, Pogo, Santa Fe, Texaco and Union.

*** None of the following companies is permitted to bid with each other on Outer Continental Shelf oil and gas lease offerings: Standard Oil Company of California, Exxon Corporation, Mobil Oil Corporation, Texaco and Shell Oil Company.

In addition, success in exploration is not based on the ability to take larger or more frequent financial risks. (Supp. App. ¶ 9.) Rather, success comes from efficient utilization, good judgment and good luck. A company that bids less frequently but finds oil obviously will do better than a well-financed company that bids often but comes up with dry holes. The key, therefore, is not financial resources.

Pennzoil simply exaggerates the requisite bid minimum when it states that it takes "[t]ens or hundreds of millions of dollars . . . to acquire the right to explore." (Supp. App. ¶ 6.) In fact, many tracts let for bid are won with the minimum acceptable bid of approximately $760,000. Further, it is misleading to assert, as Pennzoil does, that "[t]he costs of exploration are extremely high (many multiples of bidding cost)." (Supp. App. ¶ 6.) The most expensive exploration conducted to date (in the Mukluk Basin off Alaska) cost $140 million. And that is far less than what the combination bidders paid for the leases to the tracts involved. (N.Y. Times, Jan. 21, 1984, at 28, col. 4.)

Finally, Pennzoil would have this Court believe that the combined Texaco-Getty will have some extraordinary advantage by its access to Getty's present geological and geophysical data. (Supp. App. ¶¶ 10-11.) Pennzoil neglects to inform the Court that there are numerous ways that companies, regardless of size, can obtain geological and geophysical data. Frequently, seismic companies survey or "shoot" proposed sale lease tracts either alone or in syndication to reduce costs. They often sell this information to anyone interested.* In addition, if a combination of interested companies later bids on a tract where one member has paid for a survey, such information is generally made available to all members of the bidding group. Thus, while proprietary information does exist, every company has such data and no particular advantage accrues to one company or another since each has its own. Moreover, in many instances Pennzoil has the same access to geophysical data as either Texaco and Getty alone or in combination.

---

* An alternative practice is for such a company to form a syndication by inviting prospective bidders to combine and underwrite a survey. In such a case, those companies who sign on to the syndication may do so at a lower price than those who want access to the geophysical information at a later date.

Plainly, competition in exploration will not lessen substantially as a result of Texaco's acquisition of Getty.

(ii) Crude Oil Production

Although Pennzoil claims threatened injury resulting from an alleged lessening of competition in the production of crude oil, Pennzoil cannot demonstrate that the proposed acquisition will have substantial anticompetitive effects in that market. The only relevant geographic market in which to analyze the acquisition with respect to crude oil production is the entire United States, if not the world.

The area in which the seller operates and to which the purchaser practicably turns for crude oil supplies is the world. Competitors, including Texaco, Getty and Pennzoil, produce crude oil throughout the world.* Crude oil is transported worldwide from production areas to purchasers by means of pipelines, supertankers and other forms of transportation. United States refineries continue to rely on imported crude oil to meet refining demand: approximately 30% of the crude oil consumed in the United States in 1982 was imported.* The world market for crude oil is highly unconcentrated, with literally thousands of participants.

---

* Texaco produces crude oil in Europe, Canada, Latin America, West Africa, the Middle East and the Far East. Texaco 1982 Annual Report at 4. Similarly, Getty operates crude oil production facilities in the United Kingdom sector of the North Sea and the Partitioned Neutral Zone between Saudi Arabia and Kuwait. Getty 1982 Annual Report at 6. Even Pennzoil, which portrays itself as a defenseless bit player in the industry, produces or explores for crude oil in the Dutch and United Kingdom sectors of the North Sea, Canada, Colombia, Gabon, and Indonesia. Pennzoil.1982 Annual Report at 7.

Even in a more narrow, national market based on domestic crude oil production, the proposed acquisition would not substantially lessen competition, regardless of whether competition is viewed in terms of crude oil reserves or production. In 1982, the crude oil reserves of the top four firms were less than 30% of the total reserves in the United States.** Texaco has only 3.0% and Getty only 3.5% of total United States reserves.*** The combined market share of 6.5%, with an increase in the four-firm concentration ratio of 0.2%, evidences no likelihood that the proposed acquisition would substantially lessen competition in this unconcentrated market. Even if production statistics were utilized, the result would be similar. Texaco and Getty have a 3.5% and 2.7% share, respectively, of domestic crude oil production, in which the current four-firm concentration ratio of 25.2% would increase by only 1.1%.*

---

* See Petroleum Supply Annual 1982 (June 1983), Table 19 (1982 imports equalled 1,273,214,000 barrels); American Petroleum Institute, Market Shares and Individual Company Data for U.S. Energy Markets: 1950-1982, Discussion Paper #014R (November 1983) (hereinafter "API Paper"), at 84 (1982 domestic consumption was 4,297,510,000 barrels).

** Id. at 55.

*** Id.

(iii) Natural Gas Production

The natural gas consumed in the United States is produced and transported throughout North America by a multitude of firms. Thus, the only relevant geographic market that comports with "commercial realities" is a North American market.

Even in a national market, the proposed acquisition would not substantially lessen competition. In 1982, the natural gas reserves of the top four firms were 23.5% of the total reserves in the United States.** Texaco has only 3.1% and Getty a mere 1.2% of total United States reserves.*** The combined market share of 4.3%, with an increase in the four-firm concentration ratio of only 0.7%, evidences no likelihood that the proposed acquisition would substantially lessen competition in this unconcentrated market. The same result obtains using production figures. In 1982, Texaco and Getty had a 3.9% and 1.8% share, respectively, of domestic natural gas production, and the current four-firm concentration ratio of 16.7% would increase by a mere 1.8%.*

---

* *Id*. at 31.

** *Id*. at 63.

*** *Id*.

As small as they are, the natural gas market shares of Getty and Texaco, and the four-firm concentration ratios in the industry as a whole, overstate the market power held by Texaco and Getty for two distinct reasons. First, approximately 63% of Texaco's U.S. natural gas reserves, and roughly the same percentage of Getty's reserves, are committed to long-term contracts. The commitment of these reserves significantly undercuts any market power the market shares might otherwise attribute to Texaco or Getty. _See_ _United States v. General Dynamics Corp._, 415 U.S. 486, 501-02 (1974) (uncommitted reserves constitute best measure of market power). And almost all of the remainder of the two companies' domestic reserves are subject to either federal price ceilings or "rights of first refusal" under the Natural Gas Policy Act. _See_ 15 U.S.C. §§ 3312-19, 3375.

---

* _Id_. at 41.

Second, natural gas competes with heating oil, coal, nuclear energy, and hydroelectricity. The availability of these substitute fuels strictly limits the exercise of any market power that purportedly might be held by a Texaco-Getty combination with respect to natural gas.

(b) Pennzoil cannot demonstrate any substantial lessening of competition in the refining of crude oil

Pennzoil does not claim that it would be injured as a result of any lessening of competition in a crude oil refining market. (See Complaint ¶ 59.) Pennzoil nevertheless contends that Texaco's acquisition of Getty violates Section 7 in this product market, and apparently seeks to gerrymander certain areas of the country as relevant geographic markets. (See Supp. App. ¶¶ 32-33.)

Pennzoil contends that the relevant geographic markets within which to analyze the effects of the proposed acquisition upon refining are: (1) PADD I, (2) PADDs I and III combined, and (3) PADD V. (Supp. App.

¶ 32.)* As demonstrated below, PADD I does not constitute a relevant geographic market, and the effects of the proposed acquisition in the remaining purported markets are insubstantial.

In 1982, approximately 74% of the refined petroleum products consumed in PADD I were refined *outside* PADD I.** With such substantial movement of refined product into PADD I, Pennzoil's contention that PADD I represents a distinct relevant geographic market for refining does not comport with the "commercial realities" of the industry. *See* *Brown Shoe*, 370 U.S. at 336-37.

In PADDs I and III combined, even Pennzoil's alleged market share statistics suggest that the effect of the proposed acquisition on refining would be inconsequential. (*See* Supp. App. ¶ 33.) Moreover, the 1.7% increase in the four-firm concentration ratio resulting from the acquisition does not establish any substantial lessening of competition in that purported market.

---

* PADDs, which were derived from 1941 war districts (PAWs), may ~~have~~ some limited historical significance. Given the substantial domestic movement and importation of refined products, PADDs are of no relevance to Section 7 analysis.

** *See* Petroleum Supply Annual, 1982 (June 1983), Tables 19, 23.

In PADD V, Texaco would acquire Getty's Bakersfield, California refinery, which has a theoretical capacity of 60,000 barrels of crude oil per day,* and an operational capacity of 38,000 barrels per day. Either figure, when measured against the total capacity of 2.99 million barrels of crude oil per day for all refiners in PADD V,** indicates the inconsequential nature of this acquisition. Moreover, the combined Texaco-Getty will not be among the top four refining firms in PADD V, and thus the four-firm concentration ratio will not increase at all as a result of the acquisition. Accordingly, Pennzoil cannot establish the probability of a substantial lessening of competition among refiners in PADD V.

Finally, most domestic refineries are running significantly below capacity and are expected to continue to do so into the foreseeable future.*** Thus, any attempted exercise of market power by a refiner would prove completely ineffective. It would merely cause many competing refiners to bring their idle capacity on-stream.

---

* "Annual Refining Survey," Oil & Gas J., at 128, 133 (March 21, 1983).

** See id. at 128-53.

*** For example, in 1983, Texaco's refineries were running at approximately 70% of capacity.

See United States v. General Dynamics Corp., 415 U.S. at 501-02 (where there is excess capacity in a market, it is doubtful that a substantial lessening of competition would occur as a result of an acquisition in that market).

(c) Pennzoil cannot demonstrate any substantial lessening of competition in the transportation of crude oil in the Williston Basin and Kern Valley

Pennzoil claims that the acquisition by Texaco of Getty's crude oil gathering systems and pipelines in the Williston Basin of North Dakota and Montana and in the "Kern Valley" of California will substantially lessen competition in the market for transportation of crude oil. (Supp. App. ¶ 35.) Such "markets" cannot be justified as relevant markets for Section 7 purposes. There are tens of thousands of miles of pipelines interconnecting throughout the country. Assuming arguendo that the transportation of crude oil is the relevant product market and that crude oil production areas constitute relevant geographic markets, Pennzoil's claim fails for several reasons.

With respect to the Williston Basin, Getty's pipelines are common carriers under the Interstate Commerce Act, 49 U.S.C. § 1(1) et seq., and are required, inter alia, to charge "just and reasonable rates" for their service, 49 U.S.C. § 1(5), and to provide and furnish transportation on a non-discriminatory basis, 49 U.S.C. § 3(1). And Texaco owns only one pipeline there. Texaco's pipeline is 25-30 miles long, is made of 3, 4 or 6 inch pipe, and is a common carrier subject to regulation in Montana similar to that provided by the Interstate Commerce Act. Given the lack of diameter or length of Texaco's pipeline, and the pervasive regulation to which Getty's and Texaco's pipelines are subject, the "bottleneck monopoly" theory offered by Pennzoil's counsel at the January 19, 1983 conference before this Court has a hollow ring. (See Conference Tr. at 31.)

Texaco's sole pipeline in the San Joaquin Valley of California* contains 32 miles of 8 or 10 inch pipe. Such a pipeline is minuscule when compared to the extensive and larger volume pipelines operated in the area by such entities as Chevron USA, Inc., Mobil Pipe Line Co., Shell Pipe Line Co., Standard Pipe Line Co., Tosco Corp. and Union Oil of California. Pennzoil's attempt to enjoin this acquisition on the ground that the addition of some 32 miles of low volume, low capacity pipe to Getty's non-contiguous pipelines will substantially lessen competition merely underscores the insubstantiality of Pennzoil's claims.

---

* Texaco is unaware of a "Kern Valley" in California. There is a Kern river there, however. We assume that Pennzoil intended to refer to the San Joaquin Valley of California.

(d) Pennzoil cannot demonstrate any substantial lessening of competition in retail marketing of gasoline

Pennzoil alleges that there will be a substantial lessening of competition in the "gasoline" market in certain identified "states and local urban areas." (Supp. App. ¶ 27.) However, of the eighteen markets alleged, it appears that Pennzoil markets gasoline in only one, New York State. Accordingly, it is not surprising that Pennzoil cannot and does not allege any injury to itself in the proposed markets. (Complaint ¶ 59; Supp. App. ¶¶ 36-39.) Pennzoil's sole relationship to these markets is its mere hope for a "substantial expansion of Pennzoil's gasoline marketing activities" (Supp. App. ¶ 38), not an injury the antitrust laws were meant to protect.*

---

* Moreover, if Pennzoil did participate in these markets, it would only benefit as a result of any alleged lessening of competition. (See Supp. App. ¶¶ 30-31.)

Assuming that New York State is a relevant market, a Texaco-Getty combination, even using Pennzoil's overstated market shares (Texaco with 3.53%; Getty with 3.42%; four-firm concentration of 35.43%)*, cannot be said substantially to lessen competition. Moreover, the stations operated by Pennzoil are primarily in the western portion of New York while Getty and Texaco operate primarily in the eastern portion of the state.** Pennzoil has done nothing to analyze the remaining seventeen purported markets beyond merely tossing numbers on a page. Defendants' evidence at the hearing will demonstrate that, even if Pennzoil could maintain this action, a Texaco-Getty combination will not substantially lessen competition in any properly defined geographic market.

---

* The market share figures are derived from the Lundberg Survey and NPD Auto Facts. (See Supp. App. ¶ 27.) These figures tend substantially to overstate Texaco's (and other companies') market shares for a variety of reasons. Among other things, NPD Auto Facts provides only the number of gasoline stations under which each brand of gasoline is sold. It ignores such pertinent data as volume of sales, and is therefore not a reliable measure of market power. In addition, while the Lundberg Surveys include in Texaco's market share all Texaco-brand gasoline sales, most Texaco gasoline stations are operated by independent contractors who determine what prices to charge. Moreover, Lundberg Surveys (of retail gasoline prices) have been rejected due to their lack of reliability. See Hanson v. Shell Oil Co., 541 F.2d 1352, 1362 (9th Cir. 1976), cert. denied, 429 U.S. 1074 (1977).

** For a similar reason, Pennzoil did not claim that Pennsylvania is a relevant market. There, Pennzoil operates in the west and Texaco and Getty in the east.

4. Pennzoil's Speculation About Possible Future Acquisitions Is Irrelevant

Pennzoil's argument that this acquisition violates Section 7 because it may trigger a series of other mergers the cumulative effect of which may be a substantial lessening of competition is utterly devoid of merit. By its terms, Section 7 prohibits a company from acquiring another only where "the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." (Emphasis added). Accordingly, any particular acquisition must be found, on its own facts, to fall within the statute's strictures before a finding of illegality may be made.

The courts, including the Supreme Court, have recognized that possibly unlawful acquisitions in the future cannot render present acquisitions anticompetitive. For example, in Brown Shoe, the Supreme Court held that "the statute prohibits a given merger only if the effect of that merger may be substantially to lessen competition." 370 U.S. at 332 (emphasis by the Court). See United States v. Connecticut National Bank, 362 F.

Supp. 240, 287-88 (D. Conn. 1973), vacated on other grounds, 418 U.S. 656 (1974) (rejecting the argument that the "proposed merger will result in a 'triggering' of other mergers which will have anticompetitive effects," since "each future situation must be dealt with under established antitrust principles on a case by case basis"); United States v. Manufacturers Hanover Trust Co., 240 F. Supp. 867, 936 (S.D.N.Y. 1965) ("the government . . . does not prove its case simply by reciting 'Ten Little Indians,' . . . . The ultimate question is whether *this* merger, viewed in the structure, history, and probable future of the market, is of the type which Congress intended to proscribe") (emphasis by the court). See also United States v. Jerrold Electronics Corp., 187 F. Supp. 545 (E.D. Pa. 1960), aff'd per curiam, 365 U.S. 567 (1961).

Moreover, by enacting the Hart-Scott-Rodino Act in 1976, Congress provided a mechanism by which each acquisition is scrutinized by the federal government on the basis of its own facts and the competitive market conditions existing contemporaneously with the acquisition. Thus, the paramount protectors of the public interest are constantly vigilant in ensuring that

Pennzoil's "domino theory" with respect to acquisitions in the petroleum industry will not become a reality.

Pennzoil's speculative parade of possible future anticompetitive acquisitions does not support its claim that this acquisition violates Section 7. As demonstrated above, this acquisition is unlikely to produce any lessening of competition, much less a substantial lessening, and Pennzoil's conjecture about future acquisitions does not change that result.

B. Pennzoil Cannot Demonstrate That It Will Suffer Irreparable Injury Unless The Injunction Issues

The *sine qua non* for the issuance of a preliminary injunction is proof of irreparable injury; the absence of such proof mandates denial of the motion. *See, e.g.*, *Franks v. Nimmo*, 683 F.2d 1290, 1293 (10th Cir. 1982) (absent showing of irreparable harm, the court need not even address the other three requirements for preliminary injunction). Indeed, Section 16 of the Clayton Act, 15 U.S.C. § 26, expressly requires "a showing that the danger of irreparable loss or harm is immediate" before a preliminary injunction may issue.

As demonstrated in Point I, above, Pennzoil has shown no threatened injury cognizable under the antitrust laws, and for this reason alone its motion should be denied. In any event, none of Pennzoil's asserted harm is irreparable. Each of Pennzoil's claims is based upon sheer speculation about ephemeral future possibilities, none of which is supported by fact. If Pennzoil's fears ever do come to pass, Pennzoil may be adequately recompensed in a court of law at that time.

C. Pennzoil Cannot Demonstrate That Its Threatened Injury Outweighs The Damage An Injunction May Cause Texaco And Getty

Balancing the parties' respective interests requires denial of the preliminary injunction. As demonstrated above, the harm Pennzoil categorizes as "irreparable" antitrust injury does not exist. By contrast, Texaco would be deprived of a unique business opportunity for which it is willing to pay a significant premium over the pre-offer market price. An injunction would cost Texaco and Getty "a significant loss in time and expense," Chem-Nuclear Systems v. Waste Management, Inc., 1982-2 Trade Cas. (CCH) at 72,275, and would likely sound the death knell of Texaco's tender offer. See Point I, supra. Moreover, a preliminary injunction would likely brand Texaco, in the eyes of the layman, as a violator of the law, thereby irreparably injuring its chances to consummate the acquisition if it later prevails on the merits of a full trial. Copperweld Corp. v. Imetal, 403

F. Supp. 579, 608 (W.D. Pa. 1975). Clearly, the substantial harm to Texaco and Getty if the injunction is granted outweighs any imagined anticompetitive injury to Pennzoil.

D. Pennzoil Cannot Demonstrate That The Injunction, If Issued, Would Not Be Adverse To The Public Interest

Finally, in determining the propriety of a preliminary injunction, the public interest must be considered. Here, Texaco has offered Getty shareholders a significant premium for their stock. They should be allowed to decide whether to tender their shares to Texaco or to Pennzoil. See, e.g., Chem-Nuclear Systems v. Waste Management, Inc., 1982-2 Trade Cas. (CCH) at 72,275 (to grant a preliminary injunction would "deprive the [target company's] shareholders of the right to choose for themselves in free market decisions if they wish to accept [defendant's] offer."); American Medicorp v. Humana, Inc., 445 F. Supp. at 595 ("injunction would deprive [target company's] shareholders of the opportunity to express their own views about where they want their money to go, and to make their own decisions as to whether they want to opt in or opt out"); Mesa Petroleum Co. v. Aztec Oil & Gas Co., 406 F. Supp. 910, 916 (N.D. Tex. 1976) (focus in determining whether to grant a preliminary injunction in takeover case must be upon the interests of the shareholders); Copperweld Corp. v. Imetal, 403 F. Supp. at 608 ("In essence, the party with the paramount interest in this suit is the shareholder and, in the absence of a compelling reason, we do not believe that one's right to deal with his property in the market place should be abridged").

IV. THERE IS NO REASON PENNZOIL'S MOTION FOR PRELIMINARY INJUNCTIVE RELIEF SHOULD BE CONSOLIDATED WITH THE TRIAL ON THE MERITS

Rule 65(a)(2) of the Federal Rules of Civil Procedure provides:

> [b]efore or after the commencement of the hearing of an application for a preliminary injunction, the court may order the trial of the action on the merits to be advanced and consolidated with the hearing of the application.

We do not dispute that this Court has the discretion under Rule 65(a)(2) to consolidate Pennzoil's motion for a preliminary injunction with the trial on the merits. See, e.g., Drummond v. Fulton County Department of Family & Children's Services, 563 F.2d 1200, 1204 (5th Cir. 1977), cert. denied, 437 U.S. 910 (1978); Singleton v. Anson County Board of Education, 387 F.2d 349, 350 (4th Cir. 1967); Advisory Committee Note, 39 F.R.D. 69, 124 (1966).

However, as discussed in Point V below, Texaco is willing to stipulate for purposes of this action that, as a general matter, divestiture may be an appropriate remedy in a private Section 7 action. Since this remedy or another can always be fashioned later, there is no reason for consolidation under Rule 65(a)(2).

V. THIS COURT NEED NOT REACH THE ISSUE OF THE AVAILABILITY OF DIVESTITURE IN THIS CASE

While courts in other circuits have addressed the issue of whether divestiture is available as a remedy in a private Section 7 action,* the Tenth Circuit has not. This Court need not reach the issue in this case because, as mentioned above, Texaco is willing to stipulate for purposes of this action that, as a general matter, divestiture may be an appropriate remedy in a private Section 7 action. However, as demonstrated in the earlier portions of this brief, Texaco does not believe that Pennzoil is entitled to _any_ remedy, including divestiture, in the circumstances of this case.

---

* _See_, _e.g._, _IT&T Corp. v. GT&E Corp._, 518 F.2d at 920 (divestiture unavailable); _NBO Industries Treadway Cos. v. Brunswick Corp._, 523 F.2d 262, 278-79 (3d Cir. 1975), _rev'd on other grounds sub nom. Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc._, 429 U.S. 477 (1977) (questioning Ninth Circuit decision); _Julius Nasso Concrete Corp. v. DIC Concrete Corp._, 467 F. Supp. 1016, 1024-25 (S.D.N.Y. 1979) (divestiture available).

CONCLUSION

For the foregoing reasons, Texaco respectfully requests that this Court deny plaintiff's motion for injunctive relief, and dismiss the Complaint in its entirety.

Dated: Tulsa, Oklahoma
January 26, 1984

Respectfully submitted,

HALL, ESTILL, HARDWICK, GABLE
COLLINGSWORTH & NELSON
A Professional Corporation

By______________________________
(A Member of the Firm)
4100 Bank of Oklahoma Tower
One Williams Center
Tulsa, Oklahoma 74172
(918) 588-2700

Attorneys for Defendant Texaco Inc.

Of Counsel:

Stephen M. Axinn
C. Benjamin Crisman, Jr.
Douglas B. Adler
SKADDEN, ARPS, SLATE, MEAGHER & FLOM
919 Third Avenue
New York, New York 10022
(212) 371-6000

Milton J. Schubin
KAYE, SCHOLER, FIERMAN, HAYS & HANDLER
425 Park Avenue
New York, New York 10022
(212) 407-8000

Charles F. Kazlauskas, Jr.
TEXACO INC.
2000 Westchester Avenue
White Plains, New York 10650
(914) 253-4000

IN THE UNITED STATES DISTRICT COURT
DISTRICT OF RHODE ISLAND

FAIRLAWN OIL SERVICE, INC.,)
Plaintiff,)
vs.)
TEXACO INC. and)
GETTY OIL COMPANY,)
Defendants.

Ca# 84-0059P

MEMORANDUM IN OPPOSITION TO MOTION FOR TEMPORARY RESTRAINING ORDER

Defendant, Texaco Inc. ("Texaco"), submits this Memorandum in Opposition to plaintiff Fairlawn Oil Service, Inc.'s ("Fairlawn") Motion for Temporary Restraining Order enjoining the consummation of Texaco's acquisition of Getty Oil Company ("Getty").

Background

After waiting for over a month, Fairlawn, a local gasoline and heating oil distributor seeks to enjoin consummation of an acquisition by which Getty Oil shareholders stand to receive more than $10 billion. The Complaint repeats allegations which were earlier made by the Pennzoil Company, a competing bidder for Getty, and which were rejected a week ago by Judge James O. Ellison of the United States District Court for the Northern District of Oklahoma after a six day trial. Judge Ellison's Decision and Order refusing to enjoin this acquisition was affirmed by a unanimous Tenth Circuit

Court decision on February 9, 1984. Thus, the very claims presented here have already been rejected by the Court in Oklahoma and the Tenth Circuit Court of Appeals.

Fairlawn's papers omit to inform this Court of the crucial facts that all of the Getty marketing assets - including the specific terminal in question here - will be transferred to Power Test Corp., an independent marketer of petroleum products simultaneously with the acquisition by Texaco of Getty. This fact has been public information since January 29th, and is a complete answer to plaintiff's claims in this case. Indeed, Judge Ellison dismissed the identical claims made here on the strength of the Power Test agreement, on the authority of United States v. Atlantic Richfield Co., 297 F. Supp. 1061 (S.D.N.Y. 1969) aff'd. sub. nom. Bartlett v. United States, 401 U.S. 986 (1971).

Paragraph 17(d) of the agreement between Power Test and Texaco confirms explicitly that Power Test will honor all of Getty's arrangements with franchisees such as Fairlawn.

Fairlawn includes in its complaint a grabbag of claims involving products and markets all around the country as to which it clearly lacks standing to sue and as to which it could never show either a likelihood of success or any significant threat of irreparable harm. Suffice it to saythat each and every one of these claims was presented to and rejected by Judge Ellison with respect to Pennzoil. A fortiori, these claims must be rejected again.

Texaco's acquisition of Getty is subject to the pre-merger notification and reporting requirements of the Hart-Scott-Rodino Antitrust Improvements Act, Section 7A of the Clayton Act, 15 U.S.C. §18A. Pursuant to the procedures which Congress established by that Act, the Federal Trade Commission has been reviewing the proposed combination of Texaco and Getty, including the proposed sale of gasoline marketing assets to Power Test, since January 9, 1984. Both Texaco and Getty have been cooperating with the Federal Trade Commission in the conduct of its very intensive review.

Within the next few days it is anticipated that the Federal Trade Commission will complete its review of Texaco's proposed acquisition of Getty. Fairlawn has known of this acquisition for more than one month and has known of the Power Test agreement for at least ten days. Nevertheless, it delayed acting while waiting to see what happened to its colleagues from Pennzoil. Fairlawn's eleventh hour effort to use this Court to seek to thwart this most significant acquisition should be rejected on that ground alone. Moreover, the issuance of an injunction which might delay the consummation of this acquisition beyond the earliest possible date it could be effected would work substantial harm to the public shareholders of Getty. According to uncontradicted evidence introduced during the course of the proceedings in the Federal Court in Oklahoma, for each day these shareholders are deprived of the purchase price of their shares, over $2 million in interest alone is lost.

The Applicable Legal Standard

The courts have repeatedly cautioned that the grant of injunctive relief without opportunity for thorough deliberation is "an extraordinary and drastic remedy which should not be routinely granted." Buffalo Forge Co. v. Ampco-Pittsburgh Corp., 638 F.2d 568, 569 (2d Cir. 1981). The standards for granting a temporary restraining order in this Court were set forth in Silva v. East Providence Housing Authority, 390 F. Supp. 691, 695 (D.R.I. 1975):

> As this Court has frequently noted, the four primary factors to be considered on a motion for a temporary restraining order or preliminary injunction are probability of irreparable harm, probability of success on the merits, a balancing of the parties' interests, and preservation of the status quo. See, National Prisoners Reform Association v. Sharkey, 347 F. Supp. 1234 (D.R.I. 1972); McClellan v. University Heights, Inc., 338 F. Supp. 374 (D.R.I. 1982) Palmigiano v. Travisono, 317 F. Supp. 776 (D.R.I. 1970).

See also Planned Parenthood League v. Bellotti, 641 F. 2d 1006, 1009 (1st Cir. 1981). The Court of Appeals has cautioned that "none of these criteria should be slighted." Auburn News Co. v. Providence Journal Co., 659 F.2d 273, 277 (1st Cir. 1981), cert. denied, 445 U.S. 921 (1982). As demonstrated below, plaintiff cannot meet these criteria.

Plaintiff Has Not Demonstrated That It Will Succeed on the Merits

As the Court of Appeals has noted: "The moving party must exhibit a likelihood of success on the merits; indeed, the probability-of-success component has loomed large in cases before this court." Auburn News Co. v. Providence Journal Co., 659 F.2d at 277. A careful examination of plaintiff's allegations reveals that there is little likelihood that it will prevail on the merits.

The conduct complained of--the possible termination of independent Getty dealers--is completely speculative and unrelated to either the proposed acquisition or to the sale of assets. Power Test has specifically agreed by contract to continue all existing arrangements with independent Getty dealers. Fairlawn's allegations are based only on its unfounded and unwarranted belief that Power Test will act in a manner different than Getty has acted in the past. Any alleged harm to Fairlawn,in any event, would result from the independent business decision of Power Test and not from any threatened or imminent violation of the antitrust laws by defendants Texaco and Getty. See, Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U. S. 100, (1969). Thus, plaintiff is unlikely to succeed on the merits of its claim.

Plaintiff Has Not Demonstrated That It Will Suffer Irreparable Injury

It is clear that plaintiff will not suffer any immediate and irreparable harm if the acquisition of Getty by Texaco and the sale of Getty's gasoline marketing assets to Power Test are allowed to proceed in their normal course. The harm alleged by plaintiff, if it will occur at all, will occur only at some time in the distant future. Moreover, should any of the dire consequences predicted by plaintiff occur, there is no reason to believe that plaintiff could not be adequately compensated through an action for damages. In a similar case where independent distributors complained of threatened termination, it was held that "the remedy of treble damages would . . . be entirely adequate." Auburn News Co. v. Providence Journal Co., 659 F2d at 277.

A Temporary Restraining Order Would Substantially Harm Defendants

As of February 8, 1984, Getty shareholders had tendered in excess of 34.8 million shares pursuant to the Texaco tender offer. Pursuant to the offer, these shares may not be withdrawn until they are purchased by Texaco or until March 8, 1984, unless another bidder commences a tender offer. Texaco stands ready to purchase these shares as soon as the Federal Trade Commission completes its review of the merger. As noted above, for each day Getty shareholders are deprived of the purchase price of their shares, over $2 million in interest alone is lost.

Moreover, if an injunction is issued, particularly at this late stage of its tender offer, Texaco will face the "almost certain doom" of its offer. See, e.g., Missouri Portland Cement Co. v. Cargill, Inc., 498 F.2d 851, 870 (2d Cir.), cert. denied, 419 U.S. 883 (1974).

Balancing the parties' respective interests clearly requires denial of the temporary restraining order. As demonstrated above, the harm plaintiff characterizes as "irreparable" does not exist. By contrast Texaco would be deprived of a unique business opportunity for which it is willing to pay a significant premium. An injunction would not only cost Texaco and Getty "a significant loss in time and expense," Chem-Nuclear Systems v. Waste Management, Inc., 1982-2 Trade Cas. (CCH) Paragraph 64,860 at 72,275 (W.D. Wash. 1982), it would likely sound the death knell of Texaco's offer.* Clearly, the substantial harm to Texaco and Getty if the injunction is granted outweighs any imagined anticompetitive injury to plaintiff.

Preservation of the Status Quo Would Substantially Harm Defendants

Where the injury to defendants is so overwhelming, maintenance of the status quo by enjoining the acquisition or the sale of assets is decidedly less important. The Court of Appeals has admonished that the preservation of the status quo "cannot be mechanically applied." Crowley v. Local No. 82, 679 F.2d 978, 996 (1st Cir. 1982), cert. granted, 103 S.Ct. 813 (1983). "The focus always must be on prevention of injury by a proper order, not merely on preservation of the status quo." Id. at 996, quoting Canal Authority v. Callaway, 489 F.2d 567, 576 (5th Cir. 1974).

---

* Should this Court decide that plaintiff is entitled to temporary injunctive relief, it must then consider, pursuant to Rule 65(c) of the Federal Rules of Civil Procedure, an appropriate bond. In light of the great injury that would result to Texaco and to Getty's shareholders in the event the acquisition is delayed, the amount of plaintiff's bond should be substantial.

Conclusion

For the foregoing reasons, defendant respectfully requests that this Court deny plaintiff's motion for a temporary restraining order.

Dated: February 10, 1984

Respectfully submitted,

EDWARDS & ANGELL

by Joseph V Cavanagh
One Hospital Trust Plaza
Providence, Rhode Island, 02903
(401) 274-9200

Attorneys for Texaco Inc.

Of Counsel

Stephen M. Axinn, Esq.
SKADDEN, ARPS, SLATE,
MEAGHER & FLOM
919 Third Avenue
New York, New York, 10022
(212) 371-6000

IN THE UNITED STATES DISTRICT COURT
DISTRICT OF RHODE ISLAND

FAIRLAWN OIL SERVICE, INC. Plaintiff,	)	Civil Action No. 84-0059-P
vs.	)	
TEXACO INC. and GETTY OIL COMPANY, Defendants.	)	

SUPPLEMENTAL MEMORANDUM IN OPPOSITION TO MOTION FOR TEMPORARY RESTRAINING ORDER

Defendant, Texaco Inc. ("Texaco"), submits this Supplemental Memorandum in Opposition to plaintiff Fairlawn Oil Service, Inc.'s ("Fairlawn") Motion for a Temporary Restraining Order enjoining the consummation of Texaco's acquisition of Getty Oil Company ("Getty").

Preliminary Statement

In addition to the reasons set forth in Texaco's memorandum of February 10, there are two new and significant reasons for denying the Temporary Restraining Order requsted by Fairlawn and the Attorney General. First, is the revelation published on Friday evening, February 10th that the Pennzoil Company ("Pennzoil") (the competing bidder for Getty) is the moving force behind this last-minute attempt to block the acquisition. Second, is the expected imminent approval by the Federal Trade Commission of a "Consent Order" and "Agreement to Hold Separate" between Texaco, Getty and the Commission, which when approved, will eliminate any and every possible antitrust concern voiced by either Fairlawn or the Rhode Island Attorney General.

The Pennzoil Involvement

As described in our earlier memorandum, Pennzoil is a competing bidder for Getty whose offer was rejected. Last month, Pennzoil filed an antitrust complaint, in the United States District Court in Tulsa making each and every claim found in the Fairlawn Complaint. That court, after a full six day evidentiary hearing dismissed Pennzoil's application to enjoin the acquisition and ruled specifically, and on the merits, that the agreement between Texaco and Power Test cured any possible antitrust claim as to the marketing of motor gasoline or other refined products in the Northeast United States. Late on Thursday, February 9th, a Tenth Circuit Court of Appeals panel unanimously affirmed. The next morning, Fairlawn filed the instant complaint.

However, in an interview on Friday, February 10, 1984, Fairlawn's president, David Roberts, candidly acknowledged that Pennzoil is paying his legal fees. "It's lucky for me that they (Pennzoil) could foot the bill." The Evening Bulletin, Feb. 10, 1984, p. B-6, col. 1. The Houston Post of February 11, 1984 quotes Pennzoil as admiting to having contributed $50,000 to Fairlawn's "legal fund". The Houston Post Sec. C. P.C-1, Cols 4-5. Thus, it is admitted that the motivating force behind this litigation is Pennzoil.

Moreover, Fairlawn's attorney, Jack A. Blum, has been actively working with Pennzoil for several weeks and was even identified as a witness for Pennzoil in the Oklahoma hearing.* (See letter of January 27, 1984, from William R. Burke, attorney for Pennzoil to Stephen M. Axinn, attorney for Texaco.)

Pennzoil's financing of Fairlawn's lawsuit is a thinly disguised effort to secure from this Court the very relief it was denied by a sister Federal Court, after a fully litigated evidentiary hearing just one week ago. Clearly, until the acquisition is allowed to close, Pennzoil will go on lining up plaintiffs all around the Country in a last-minute effort to see if, perhaps, some Court will enjoin this transaction.

---

* Mr. Blum's name was withdrawn as a witness at the last minute, obviously for fear that on cross-examination, Pennzoil's plan to resort to another court, if it was unsuccessful in Tulsa, would be revealed.

Under the circumstances, it is clear that Pennzoil is the motivating force behind this litigation and, for the reasons set forth below, this action should be barred and the temporary restraining order denied, on the principles of collateral estoppel.

Developments at the Federal Trade Commission

The F.T.C. has been investigating the acquisition since approximately January 9, 1984. The Commission's staff has reviewed many thousands of documents and has interviewed numerous employees of the Companies.

Late Friday, February 10th, the staff and Texaco agreed on the terms of a "Consent Order" and an "Agreement to Hold Separate." We understand that the five member Commission is meeting this morning to consider and vote on these agreements. If approved, as is anticipated, Texaco will place all the Getty marketing assets which are involved in this case in a "hold separate" status, pursuant to which Texaco "shall not exercise direction or control over, or influence directly or indirectly any of Getty's oil and gas assets or businesses". Furthermore, within one year Texaco shall divest Getty's petroleum related assets in the North East - including specifically Rhode Island - and its Westville N.J. refinery to a buyer or buyers to be approved by the F.T.C. If this does not occur within 12 months, Texaco has consented to the appointment of an independent trustee who shall thereafter divest these and other Getty properties. Texaco will propose that Power Test Corp. be the approved purchaser of the Getty marketing assets in the Northeast region, including Rhode Island.

Thus, assuming approval is forthcoming, as is expected, the FTC Consent Order will resolve any conceivable antitrust objection these plaintiffs might have had in the most complete and pro-competitive manner that could be devised. Accordingly, these plaintiffs cannot show that they are likely to suffer any threat of irreparable harm or that they have any likelihood of success on the merits. Nor can they show that the public interest is not fully protected by the agreements reached with the F.T.C. Lastly, the balance of hardships tips decidedly against the issuance of any restraining order since: (1) the tens of thousands of Getty shareholders and employees will suffer losses amounting to literally hundreds of millions and perhaps billions of dollars if, as a result of a stay or an injunction, this acquisition is delayed and therefore falls apart; (2) This "Pennzoil - sponsored plaintiff" is seeking to overturn a result reached by another Federal Court after careful and exhaustive study which has been affirmed on appeal; and (3) Fairlawn's rights are fully protected both by The FTC Consent Order and Agreement to Hold Separate as well as by the Power Test Agreement.

The Fairlawn Complaint Should be Dismissed On The Principles of Collateral Estoppel

In Montana v. United States, 440 U.S. 147, 153-54 (1979), the Supreme Court stated the fundamental policy underlying collateral estoppel as follows: "To preclude parties from contesting matters that they have had a full and fair opportunity to litigate protects their adversaries from the expense and vexation attending multiple lawsuits, conserves judicial resources, and fosters reliance on judicial action by minimizing the posssibility of inconsistent decisions." Accord United States v. Mendoza, 52 U.S.L.W. 4019, 4021 (U.S. 1984); United States v. Stauffer Chemical Co., 52 U.S.L.W. 4022, 4024 (U.S. 1984); Allen v. McCurry, 449 U.S. 90, 94 (1980). The Court in Montana went on to add, in language particularly relevant to these preceedings, that "[t]hese interests are similarly implicated when nonparties assume control over litigation in which they have a direct financial or proprietary interest and then seek to redetermine issues previously resolved." Id. at 154.

As noted above, the evidence is compelling that Pennzoil is encouraging, aiding and financing this litigation. Pennzoil is paying Fairlawn's legal fees; the Fairlawn complaint tracks the language of Pennzoil's prior pleadings, and Fairlawn's lawyer has been working with Pennzoil and agreed to be a witness for Pennzoil in the Oklahoma litigation. These facts alone are sufficient to find that Pennzoil has provided the "laboring oar" in this action to justify invocation of collateral estoppel principles. Id. at 155.

The present action is only a thinly-disguised attempt by Pennzoil to relitigate claims previously rejected by another federal court. Pennzoil's interest in stopping Texaco's offer and acquiring Getty for itself, overwhelms any speculative and insubstantial injury Fairlawn seeks to avoid. Failure to recognize Pennzoil's presence in this litigation is an open invitation to Pennzoil to buy plaintiffs in every judicial district in the country in the hopes of finding a court that will assist it in acquiring Getty for itself.

The issues raised by this complaint and the motion for a temporary restraining order were fully and fairly litigated in the course of a six-day hearing before Judge Ellison in the Northern District of Oklahoma.* They were rejected in that jurisdiction, and they should be rejected here.

---

* The fact that the judgment in Oklahoma was a denial of a preliminary injunction does not preclude application of principles of collateral estoppel. See, Miller Brewing Co. v. Jos. Schlitz Brewing Co., 605 F.2d 990, 995 (7th Cir. 1979) cert. denied, 444 U.S. 1102 (1980); accord Miller Brewing Co. v. Falstaff Brewing Corp., 655 F.2d 5, 9 (1st Cir. 1981).

Conclusion

For the foregoing reasons and for the reasons set forth in the Memorandum in Opposition to Motion for Temporary Restraining Order filed on February 10, 1984, Texaco respectfully requests that this Court deny plaintiff's motion for a temporary restraining order.

Dated: February 13, 1984

Respectfully submitted,

EDWARDS & ANGELL

by Joseph V. Cavanagh, Jr.
One Hospital Trust Plaza
Providence, Rhode Island 02903
(401) 274-9200

Attorneys for Texaco Inc.

Of Counsel

Stephen M. Axinn, Esq.
SKADDEN, ARPS, SLATE,
MEAGHER & FLOM
919 Third Avenue
New York, New York 10022
(212) 371-6000

Charles F. Kazlauskas, Jr. Esq,.
TEXACO INC.
2000 Westchester Avenue
White Plains, New York 10060
(914) 253-6211

Robert R. Popeo, Esq.
Mintz, Levin, Cohn, Ferris,
Glovsky and Popeo, P.C.
Suite 600
One Center Plaza
Boston, Massachusetts 02108
(617) 752-5800

DISTRICT COURT OF THE UNITED STATES

FOR THE DISTRICT OF RHODE ISLAND

FAIRLAWN OIL SERVICE, INC.)
)
v.) Civil Action No. 84-0059 P
)
TEXACO, INC.)
GETTY OIL COMPANY)

MEMORANDUM AND ORDER

PETTINE, Senior District Judge. Plaintiff, Fairlawn Oil Service, seeks to temporarily enjoin, under Section 16 of the Clayton Act, 15 U.S.C. §26 (Act) the merger between Texaco, Inc. and Getty Oil Company. The State of Rhode Island seeks to intervene in this case to represent both its interests as a consumer and to represent the public in general. Both Fairlawn and the State have requested that this Court issue a temporary restraining order. The grounds for the equity relief they seek are that a merger of the two companies would violate §7 of the Act, 15 U.S.C. §18.

It is the Court's opinion that the temporary restraining order must be denied.

Standing - State of Rhode Island

The State of Rhode Island has standing to intervene in this action.

The State alleges standing both in its capacity as the representative of itself and cities and towns as consumers of petroleum products, and in its capacity as parens patriae. As the Supreme Court made clear in Hawaii v. Standard Oil Co., 405 U.S. 251 (1972), states may sue for injunctive relief only in their status as parens patriae. The Supreme Court also stated that a state may sue for both damages and injunctive relief in its proprietary capacity. Consideration of the State's motion for a temporary restraining order, however, is the same on either basis at this time -- therefore, the Court will simultaneously consider its motion in both postures.

The Right to Sue

Section 16 of the Clayton Act, 15 U.S.C. §26 provides:

> Any person, firm, corporation, or association shall be entitled to sue for and have injunctive relief ... against threatened loss or damage by a violation of the antitrust laws ... when, and under the same conditions and principles as injunctive relief against threatened conduct that will cause loss or damage, is granted by the courts of equity ....

Preliminary Relief - The Legal Standard

Absent an adequate remedy at law, the plaintiff must show (1) a likelihood of success on the merits; (2) irreparable injury if the temporary restraining order is not granted;

(3) such injury outweighs any harm that granting injunctive relief would inflict on the defendant; (4) the public interest will not be adversely affected by the grant of the injunction; and (5) preservation of the status quo. Silva v. East Providence Housing Authority, 390 F.Supp. 691, 695 (D.R.I. 1975); Auburn News Co. v. Providence Journal Co., 695 F.2d 273 (1st Cir. 1981).

It is true as the plaintiff argues that the application of these standards to a particular set of facts is not a mechanical process. National Tank Truck Carriers, Inc. v. Burke, 608 F.2d 819, 823 (1st Cir. 1979). And the Second Circuit did state in Gulf Western Industries, Inc. v. Great Atlantic & Pacific Tea Co., 476 F.2d 687, 692-93 (2d Cir. 1973), quoting Checker Motors Corp. v. Chrysler Corp., 405 F.2d 319, 323 (2d Cir.), cert. denied, 394 U.S. 999 (1969):

> The purpose of a preliminary injunction is to maintain the status quo pending a final determination of the merits.... It is an extraordinary remedy, and will not be granted except upon a clear showing of probable success and possible irreparable injury.... However, "the burden [of showing probable success] is less where the balance of hardships tips decidely toward the party requesting the temporary relief." In such a case, the moving party may obtain a preliminary injunction if he has raised questions going to the merits so serious, substantial, and difficult as to make them a fair ground for litigation and thus for more deliberate investigation.

However, it is also true that the First Circuit Court of Appeals has cautioned that "none of these criteria should be slighted." Auburn News Co., supra, at 277. Finally, no citation of authority is necessary to say that conjecture and speculative conclusions are of no help in attempting to establish any of the foregoing criteria.

The core issue is whether the plaintiff has raised serious, substantial, difficult and doubtful questions -- this is its burden. Pennzoil Company v. Texaco, Inc. and Getty Oil Company, (Slip op. No. 84-C-29-E, N.D. Oklahoma, Feb. 8, 1984):

> To prevail in a suit under §16 of the Act, the Plaintiff is required to show a "significant threat of injury from impending violations of antitrust laws...." 15 U.S.C. §26; Zenith v. Hazeltine Research, Inc., 395 U.S. 100, 89 S.Ct. 1562 (1969). A threat of injury must be based upon more than mere conjecture or speculation. There must be a showing that there is a dangerous probability that injury will occur. See Okefenokee Rural Electric Membership Corp. v. Florida Power and Light, 214 F.2d 413 (5th Cir. 1954). It must also be shown that the threatened loss or damage be a of a sort that is personal to the Plaintiff. United States v. Borden Company, 347 U.S. 514, 74 S.Ct. 703 (1954).
>
> Slip op. at 3.

The Court has found it rather difficult to find any concrete and pertinent injury to the plaintiff in its brief.

In capsulized form, it evolves its discussion by asserting that gasoline comprises a separate product market, Marathon Oil Co. v. Mobil Corp., 530 F.Supp. 315 (N.D. Ohio), aff'd, 669 F.2d 378 (6th Cir. 1981); Section 7 of the Clayton Act proscribes mergers which substantially lessen competition or tend to create a monopoly "in any section of the country." 15 U.S.C. §18. This term has been defined as any geographic market or submarket in which an adverse effect may result from an acquisition. Marathon Oil Co., supra; Brown Shoe Co. v. United States, 370 U.S. 294 (1962). Rhode Island constitutes a geographical market within the meaning of the Act. The plaintiff then jumps to such conclusions as, "If the largest merger in U.S. history is permitted, the stage will be set for a series of other acquisitions in the petroleum industry, as major oil companies scramble to acquire oil reserves and other competitive advantages." Brief at 23. "In any industry where exploration for new oil reserves is extremely expensive, acquisitions will provide an alternative method for obtaining petroleum reserves. The effect will be a substantial lessening of competition in the petroleum industry, increased dependence on foreign sources of supply and higher prices." Brief at 24. As the plaintiff states at page 26 of its Brief:

> With respect to the combined post-merger market share of Texaco in Providence, Rhode Island, it reaches 22.6% , with a

post-merger four-firm concentration ratio of 67.6%. This is significantly higher than that reflected in any geographic area in the Marathon/Mobil merger. Yet in the Marathon case, the court concluded:

> In all cases which this court has examined the United States Supreme Court has held illegal the consolidation of two vibrant and highly competitive industrial firms, each of which has a substantial share of a significant market. There is little doubt that the combined market shares of Mobil and Marathon in the states of Illinois, Indiana, Michigan, Ohio, Tennessee and Wisconsin would approach or surpass those found to constitute Section 7 violations in Brown Shoe and Pabst. Accordingly, at this stage of the proceedings, this court holds that Marathon has shown a reasonable probability that it will succeed at trial on the merits of the issue of probable substantial lessening of competition in the states of Illinois, Indiana, Michigan, Ohio, Tennessee and Wisconsin as a result of the proposed merger. Therefore Marathon's motion for a preliminary injunction restraining Mobil from carrying out the proposed acquisition is granted.
>
> 530 F.Supp. at 326.

The plaintiff concludes that all this is legally sufficient to grant the restraining order because it will, in turn, be irreparably harmed by the lack of competition between Getty and Texaco. "Getty's motor gasoline sales to Fairlawn have been at prices which enabled the gasoline to be resold at competitive prices both at the wholesale and retail levels. The elimination of Getty as a supplier will effectively destroy Fairlawn's price competitiveness, as well as the price competitiveness of the retail outlets which Fairlawn supplies." Brief at 27.

This is a tenuous argument; it fails to note that defendant Texaco has submitted with its memorandum an agreement between it and Power Test Corporation, under which Texaco will sell to Power Test all rights to the Getty mark, the right to distribute through Getty's former outlets, and the right to buy these outlets in all states east of the Mississippi River and the District of Columbia with the exception of Illinois, Wisconsin, Louisiana and Minnesota. Under this agreement, Power Test also agrees to supply all former customers of Getty, such as Fairlawn. Texaco agrees to supply Power Test with much of its petroleum needs for three years.

Given this agreement, Fairlawn's calculations of Texaco's market share after the merger are inaccurate. Additionally, much of the harm which Fairlawn alleges is made very speculative by the agreement.

Given that Power Test has specifically agreed by contract to continue all existing arrangements with independent Getty dealers, the defendants are correct in claiming that, "Fairlawn's allegations are based only on its unfounded and unwarranted belief that Power Test will act in a manner different than Getty has acted in the past. Any alleged harm to Fairlawn, in any event, would result from the independent or imminent violation of the antitrust laws by defendants Texaco and Getty. See, Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100 (1969)."

Fairlawn is the plaintiff here -- it is the focus in applying the criteria, set forth supra; in doing so, it has failed to establish it will suffer a significant threat of injury from this merger based upon more than mere conjecture or speculation. It may be the predictions will prove true, but I am not permitted to play the role of a prognosticator with a theorizing crystal ball.

The plaintiff seeks to invoke claims involving markets around the country. Based on this record, its nexus to such national implications is an insubstantial bridge that will not support "standing." But even if I were to consider the effect that the merger would have on the concentration of crude oil refining capacity in the northeastern United States, I must say that at this time I am unable to grant a temporary restraining order based on the information presented to me in the plaintiff's memorandum. Although Texaco and Getty would have a combined firm share of refining capacity equalling fourteen percent in Petroleum Alloation for Defense District I (PADD I), the Court has insufficient information as to whether refining capacity in PADD I is the relevant geographic market. As plaintiff's memorandum indicates, refined petroleum products enter the Northeast from other areas through various means, including pipelines. The plaintiff contends that the Court should consider the combined refining capacity of Texaco and Getty in PADD I and PADD III. However, again the Court has insufficient information to determine preliminarily whether PADDs I and III combined represent the relevant geographic market for oil refining. Additionally, the combined refining capacity in PADDs I and III of Texaco post-merger would be 8.8 percent -- a percentage which may or may not establish sufficient concentration to prevail on the merits. Again, Fairlawn's motion for a temporary restraining order must be denied.

Accepting the representation made in the defendants' brief, the Court points out that:

> Texaco's acquisition of Getty is subject to the pre-merger notification and reporting requirements of the Hart-Scott-Rodino Antitrust Improvements Act, Section 7A of the Clayton Act, 15 U.S.C. §18A. Pursuant to the procedures which Congress established by that Act, the Federal Trade Commission has been reviewing the proposed combination of Texaco and Getty, including the proposed sale of gasoline marketing assets to Power Test, since January 9, 1984. Both Texaco and Getty have been cooperating with the Federal Trade Commission in the conduct of its very intensive review.
>
> Within the next few days it is anticipated that the Federal Trade Commission will complete its review of Texaco's proposed acquisition of Getty. Fairlawn has known of this acquisition for more than one month and has known of the Power Test agreement for at least ten days. Nevertheless, it delayed acting while

> waiting to see what happened to its colleagues from Pennzoil. Fairlawn's eleventh hour effort to use this Court to seek to thwart this most significant acquisition should be rejected on that ground alone. Moreover, the issuance of an injunction which might delay the consummation of this acquisition beyond the earliest possible date it could be effected would work substantial harm to the public shareholders of Getty. According to uncontradicted evidence introduced during the course of proceedings in the Federal Court in Oklahoma, for each day these shareholders are deprived of the purchase price of their shares, over $2 million in interest alone is lost.

Finally, the plaintiff claims it has no adequate remedy at law. I pose the question why wouldn't "the remedy of treble damages ... be entirely adequate"? Auburn News Co. v. Providence Journal Co., 659 F.2d at 277, supra.

State of Rhode Island

The State has not submitted any information to the Court which would show how much it would be harmed by the merger of Texaco and Getty. Looking to the information in Fairlawn's brief and the information in Texaco's brief, the Court feels that the injury to the State and the amount of the increases in the relevant market shares are insufficient to show that the State has a likelihood of success on the merits. As the Court noted above, Texaco's agreement with Power Test casts great doubt on how much the retail gasoline market will be affected by the merger. Additionally, as noted above, the Court has insufficient information to conclude that the increase in refining capacity merits granting a temporary restraining order. Moreover, the Court has virtually no information to judge the effect of the merger on the home heating oil market in Rhode Island. Finally, the State of Pennsylvania's amicus brief sheds little new light on the propriety of a temporary restraining order.

For the foregoing reasons, Fairlawn's motion for a temporary restraining order is hereby denied. Additionally, intervenor State of Rhode Island's motion for a temporary restraining order is also denied.*

By Order,

Deputy Clerk

Enter:

Raymond J. Pettine
Senior Judge

February 13, 1984

---

* Whether or not the appellate court, should the plaintiff seek its intervention, grant the relief herein denied, I am prepared to grant a hearing for preliminary injunction on a priority basis.

Attachment C

federal register

Wednesday
March 7, 1984

Part III

Federal Trade Commission

16 CFR Part 13

Texaco Inc. and Getty Oil Co.; Proposed Consent Agreement With Analysis To Aid Public Comment

FEDERAL TRADE COMMISSION

16 CFR Part 13

[File No. 841-0077]

Texaco Inc. and Getty Oil Co.; Proposed Consent Agreement With Analysis To Aid Public Comment

AGENCY: Federal Trade Commission.

ACTION: Proposed Consent Agreement.

SUMMARY: The Federal Trade Commission has provisionally accepted a consent agreement with Texaco Inc. and Getty Oil Company in settlement of a complaint alleging violations of Section 7 of the Clayton Act and Section 5 of the Federal Trade Commission Act. The consent agreement, accepted subject to final Commission approval, would require Texaco Inc. to divest, within 12 months, all Getty assets listed in Schedule A to a Commission-approved buyer(s). Should any of the assets not be timely divested, a trustee appointed by the court or the Commission will have 18 months to effect divestiture of the remaining assets. Additionally, for a period of ten years, Texaco would be required to vote its shares in favor of any proposal to increase the capacity or enhance the ability of the Colonial Pipeline Company to transport refined product north of Dorsey Junction, Maryland. The order would also require Texaco to sell crude oil of similar grade and quality to most California buyers who were customers of Getty in 1983, for a period of five years, and offer access to Getty's pipeline from Santa Fe Springs to Los Angeles to any Getty customer using the pipeline in 1983, for a period of ten years. Texaco would be prohibited from acquiring, without prior Commission approval, any interest in any concern engaged in: (1) Refining or wholesale distribution of gasoline or middle distillate in 12 eastern states and the District of Columbia, and (2) any petroleum product pipeline transportation in or into Colorado.

DATE: Comments must be received on or before May 7, 1984.

ADDRESS: Comments should be directed to: FTC/S, Office of the Secretary, Washington, D.C. 20580.

FOR FURTHER INFORMATION CONTACT: FTC/CS-4, Marc G. Schildkraut, Washington, D.C. 20580, (202) 724-1424.

SUPPLEMENTARY INFORMATION: Pursuant to Section 6(f) of the Federal Trade Commission Act, 38 Stat. 721, 15 U.S.C. 46 and § 2.34 of the Commission's Rules of Practice (16 CFR 2.34), notice is hereby given that the following consent agreement containing a consent order to cease and desist and an explanation thereof, having been filed with and accepted, subject to final approval, by the Commission, has been placed on the public record for a period of sixty (60) days. Public comment is invited. Such comments or views will be considered by the Commission and will be available for inspection and copying at its principal office in accordance with Section 4.9(b)(14) of the Commission's Rules of Practice (16 CFR 4.9(b)(14)).

List of Subjects in 16 CFR Part 13

Gasoline, Mergers, Petroleum products, Trade practices.

Federal Trade Commission

[File No. 841-0077]

Agreement Containing Consent Order

In the Matter of Texaco Inc., a corporation, and Getty Oil Company, a corporation.

The FTC having initiated an investigation of the proposed acquisition of shares in Getty Oil Company ("Getty") by Texaco Inc. ("Texaco"), and Texaco having been furnished with a copy of a draft complaint that the Bureau of Competition has presented to the Commission for its consideration, and which, if issued by the Commission would charge Texaco and Getty with violations of the Clayton Act and Federal Trade Commission Act, and it now appearing that Texaco and Getty are willing to enter into an agreement containing an order to divest certain assets and to cease and desist from certain acts:

It is hereby agreed by and between Texaco and Getty, by their duly authorized officers and their attorneys, and counsel for the Federal Trade Commission ("the Commission") that:

1. Texaco is a corporation organized under the laws of Delaware with its executive office at 2000 Westchester Avenue, White Plains, New York 10650.

Getty is a corporation organized under the laws of Delaware with its executive office at 3810 Wilshire Boulevard, Los Angeles, California 90010.

2. Texaco and Getty admit all jurisdictional facts set forth in the draft of complaint here attached.

3. Texaco and Getty waive:

a. Any further procedural steps;

b. The requirement that the Commission's decision contain a statement of findings of fact and conclusions of law;

c. all rights to seek judicial review or otherwise to challenge or contest the validity of the order entered pursuant to this agreement; and

d. All rights under the Equal Access to Justice Act.

4. This agreement shall not become a part of the public record unless and until it is accepted by the Commission. If this agreement is accepted by the Commission, it, together with the draft of complaint contemplated thereby, will be placed on the public record for a period of sixty (60) days and information in respect thereto publicly released. The Commission thereafter may either withdraw its acceptance of this agreement and so notify Texaco and Getty, in which event it will take such action as it may consider appropriate, or issue and serve its complaint (in such form as the circumstances may require) and decision, in disposition of the proceeding.

5. This agreement is for settlement purposes only and does not constitute an admission by Texaco and Getty that the law has been violated as alleged in the draft of complaint here attached.

6. This agreement contemplates that, if it is accepted by the Commission, and if such acceptance is not subsequently withdrawn by the Commission pursuant to the provisions of Section 2.34 of the Commission's Rules, the Commission may, without further notice to Texaco and Getty: (1) Issue its complaint corresponding in form and substance with the draft of the complaint attached hereto and its decision containing the following order to divest and to cease and desist in disposition of the proceeding, and (2) make information public with respect thereto. When so entered, the order to divest and to cease and desist shall have the same force and effect and may be altered, modified or set aside in the same manner and within the same time provided by statute for other orders. The order shall become final upon service. Delivery by the U.S. Postal Service of the complaint and decision containing the agreed-to order to Texaco's and Getty's addresses as stated in this agreement shall constitute service. Texaco and Getty waive any right they may have to any other manner of service. The complaint may be used in construing the terms of the order, and no agreement, understanding, representation, or interpretation not contained in the order or the agreement may be used to vary or contradict the terms of the order.

7. Texaco and Getty have read the draft of complaint and order contempleated hereby. They understand that once the order has been issued, they will be required to file one or more compliance reports showing that they have fully complied with the order. Texaco and Getty further understand

that they may be liable for civil penalties in the amount provided by law for each violation of the order after it becomes final.

Order

I

As used in this Order the following definitions shall apply:

(a) The "Acquisition" means Texaco's aquisition of the common stock of Getty.

(b) "Schedule A Properties" means the assets and business listed in Schedue A of this agreement.

(c) "Getty" means Getty Oil Company, as it was constituted prior to the acquisition, including its parents, predcessors, subsidiaries, divisions, groups, affiliate entities, and their directors, offiters, employees, agents and representatives, and their successors and assigns.

(d) "Texaco" means Texaco Inc., its predecessors, subsidiaries, divisions, groups, affiliate entities, and their directors, officers, employees, agents and representatives, and their successors and assigns.

II

It is ordered that:

(A) Within 12 months of the date of service of this order, Texaco shall divest, absolutely and in good faith, the Schedule A properties.

(B) Divestiture of the Schedule A properties shall be made only to an acquirer or acquirers, and only in a manner, that receive the prior approval of the Federal Trade Commission. The purpose of the divestiture of the properties in paragraph 1 of Schedule A is to ensure the contanuation of the assets as an ongoing, viable petroleum marketing business and to remedy the lessening of competition resulting from the Acquisition as alleged in the Commission's complaint. The purpose of the divestiture of the properties in paragraph 2 of Schedule A is to ensure the continuation of the assets as an ongoing, viable petroleum refining and marketing business and to remedy the lessening of competition resulting from the Acquisition as alleged in the Commission's complaint.

(C) If Texaco has not divested the Schedule A properties within the 12-month period, Texaco shall consent to the appointment of a trustee in any action that the Federal Trade Commission may bring pursuant to section 5(*l*) of the Federal Trade Commission Act, 15 U.S.C. 45 (*l*), or any other statute enforced by the Commission. In the event the court declines to appoint a trustee, Texaco shall consent to the appointment of a trustee by the Commission pursuant to this order. The appointment of a trustee shall not preclude the Commission from seeking civil penalties and other relief available to it for any failure by Texaco to comply with paragraphs II(C) through IX of this order.

(D) If a trustee is appointed by a Court or the Commission pursuant to Paragraph II(C) of this Order, Texaco shall consent to the following terms and conditions regarding the trustee's duties and responsibilities:

1. The Commission shall select the trustee, subject to Texaco's consent, which shall not be unreasonably withheld. The trustee shall be a person with experience and expertise in acquisitions and divestitures.

2. The trustee shall have the power and authority to divest any Schedule A properties that have not been divested by Texaco within the time period for divestiture, which shall be subject to the trustee shall have 18 months from the date of appointment to accomplish the divesture, which shall be subject to the prior approval of the Commission and if the trustee was appointed by a court, subject also to the prior approval of the court. If, however, at the end of the 18-month period the trustee has submitted a plan of divestiture or believes that divestiture can be achieved within a reasonable time, the divestiture period may be extended by the Commission or by the court, if the trustee was appointed by a court.

3. The trustee shall have full and complete access to the personnel, books, records and facilities of any business that the trustee has the duty to divest, and Texaco shall develop such financial or other information relevant to the assets to be divested as such trustee may reasonably request. Texaco shall cooperate with the trustee, and shall take no action to interfere with or impede the trustee's accomplishment of the divestiture.

4. The power and authority of the trustee to divest shall be at the most favorable price and terms available consistent with the Order's absolute and unconditional obligation to divest and the purposes of the divestiture as stated in paragraph II(B).

5. The trustee shall serve at the cost and expense of Texaco on such reasonable and customary terms and conditions as the Commission or a court may set. The trustee shall account for all monies derived from the sale and all expenses incurred. After approval by the court or the Commission of the account of the trustee, including fees for his or her services, all remaining monies shall be paid to Texaco and the trustee's power shall be terminated. The trustee's compensation shall be based at least in significant part on a commission arrangement contingent on the trustee divesting the trust property.

6. Promptly upon appointment of the trustee and subject to the approval of the Commission, Texaco and Getty shall, subject to the Commission's prior approval and consistent with provisions of this order, execute a trust agreement that transfers to the trustee all rights and powers necessary to permit the trustee to cause divestiture.

7. If the trustee ceases to act or fails to act diligently, a substitute trustee shall be appointed.

8. The trustee shall report in writing to Texaco and the Commission every sixty (60) days concerning the trustee's efforts to accomplish divestiture.

(E) Texaco shall maintain the viability and marketability of the Schedule A properties and shall not cause or permit the destruction, removal or impairment of any assets or businesses to be divested except in the ordinary course of business and except for ordinary wear and tear.

III

It is further ordered that, within sixty (60) days after the date of service of this order, and every sixty (60) days thereafter until Texaco has fully complied with the provisions of Paragraph II of this order, Texaco shall submit to the Federal Trade Commission a verified written report setting forth in detail the manner and form in which it intends to comply, is complying with, or has complied with that provision. Texaco shall include in compliance reports, among other things that are required from time to time, a full description of contacts or negotiations for the divestiture of properties specified in paragraph II of this order, including the identity of all parties contacted. Texaco also shall include in its compliance reports copies of all written communications to and from such parties, and all internal memoranda, reports, and recommendations concerning divestiture.

IV

It is further ordered that, for ten (10) years following the date that this Order shall become final, Texaco shall support, vote in favor of and take no action to impede any and all proposals and actions (including placing the matter on agenda for discussion, study proposals, feasibility studies, or engineering studies) that have been made or supported by any owner of an interest in the Colonial Pipeline Company to expand, extend, or otherwise increase the capacity of the Colonial Pipeline north of Dorsey Junction, Maryland or otherwise to increase or enhance the ability of the Colonial Pipeline to transport refined product north of Dorsey Junction, Maryland.

V

It is further ordered that Texaco continue to offer to sell to all California buyers who were customers of Getty in 1983 or other buyers pursuant to paragraph 4 of Schedule B of this Order, except Atlantic Richfield Co., Chevron U.S.A., Inc., Exxon Co., Gulf Oil Co., Mobil Oil Corp., Shell Oil Co., Standard Oil Co. (Ohio), British Petroleum Co. and Union Oil Co., crude oil of similar grade and quality to that being sold by Getty in 1983 to such customers in accordance with the terms and conditions listed in Schedule B.

VI

It is further ordered that, for ten (10) years following the date that this Order shall become final, Texaco shall offer access to Getty's pipeline from Santa Fe Springs to Los Angeles to any Getty customer using the pipeline in 1983 in accordance with the terms and conditions in effect in 1983. Transportation fees shall be the fees levied for Getty's most recent arrangement in effect in December 1983 for comparable transportation, adjusted for the Fuels and Related Products and Power Index, Part of Producer Prices and Price Index, U.S. Department of Labor, Bureau of Labor Statistics. Any disputes between Texaco and any customer shall be settled by binding arbitration. If the parties are unable to agree on an arbitrator, the dispute shall be settled pursuant to the commercial arbitration rules of the American Arbitration Association.

VII

It is further ordered that for a period commencing on the date of service of this order and continuing for ten (10) years from and after the date of service of this order, Texaco shall cease and desist from acquiring, without the prior approval of the Federal Trade Commission, directly or indirectly, through subsidiaries or otherwise, assets used or previously used in (and still suitable for use in), any interest in, or the whole or any part of the stock, or share capital of any company that is engaged in:

(A) Refining or the wholesale distribution of gasoline or middle distillates (including terminals and bulk plants) in Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, New York, New Jersey, Pennsylvania, Delaware, Maryland, West Virginia, or the District of Columbia; or

(B) Any petroleum product pipeline transportation in or into Colorado.

Provided, however, these prohibitions shall not relate to the construction of new facilities or participation in joint ventures in which Texaco is a participant on the date of service of the Order.

One year from the date of service of this order and annually thereafter Texaco shall file with the Commission a verified written report of its compliance with this paragraph.

VIII

For the purpose of determining or securing compliance with this Order, and subject to any legally recognized privilege, upon written request and on reasonable notice to Texaco or Getty made to its principal office, Texaco and Getty shall permit any duly authorized representatives of the Commission:

(A) Access during the office hours in the presence of counsel, to inspect and copy all books, ledgers, accounts, correspondence, memoranda, and other records and documents in the possession or under the control of Texaco or Getty relating to any matters contained in this Order; and

(B) Upon five days notice to Texaco or Getty and without restraint or interference from them, to interview officers or employees of respondents, who may have counsel present, regarding any such matters.

IX

It is further ordered that Texaco notify the Commission at least thirty (30) days prior to any proposed change in the corporation such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any other change that may affect compliance obligations arising out the order.

Schedule A

Schedule of Assets and Operations

1. Getty's petroleum-related assets located in Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, New York, New Jersey, Pennsylvania, Delaware, Maryland, West Virignia, and the District of Columbia, other than the Getty refinery located in Delaware and the Getty crude handling facility, product pipeline, and terminal connected to the refinery, and 30 of the properties listed in Schedule C.

2. The Getty Refining and Marketing Company's El Dorado, Kansas refinery and related crude pipelines and terminals including its interest in Texoma Pipeline Co., Osage Pipeline Co., Boyer Pipeline, the Oklahoma-Kansas portion of Getty Pipeline, Inc. and Cushing Crude Terminal. Getty Refining and Marketing Company's marketing, sales and transportation assets in: Colorado, Illinois, Indiana, Iowa, Kansas, Minnesota, Michigan, Missouri, Nebraska, North Dakota, Oklahoma, South Dakota, Wisconsin, Wyoming and Texas and its ownership interest in the Chase Transportation Company and the Chase Terminal Co.

3. Texaco's Eagle Point refinery (Westville, N.J.), including any crude handling facilities, terminals or wholly-owned pipelines connected to the refinery.

Schedule B

Terms and Conditions

Texaco shall offer Getty California crude oil for use in connection with the buyer's refining facility (either directly or via exchanges) on the contractual terms and conditions set out below. Notwithstanding such offer the parties may agree to other terms and conditions.

1. *Term*—From the date the contract of any Getty customer terminates or from the date of the final acceptance by the Commission of the Consent Order, if no contract exists, until July 1, 1989, or such shorter term desired by the Getty customer.

2. *Price*—The maximum price shall be determined as follows:

(a) The weighted average of the prices posted for crude oil in the field where produced by those of the following companies that post prices for similar crude oil in that field:

Shell Oil Company
Standard Oil of California
Mobil Oil Corporation
Atlantic Richfield Company
Union Oil Company of California
Texaco Inc. (except that Texaco may be weighted no more than 25 percent in the average price)
Any company that purchased or purchased and produced during the previous six (6) calendar months not less than fifteen percent (15%) of the crude oil produced in the field.

(b) If one or more of the posters in a field, except Texaco, shall post a price higher for crude oil in that field higher than the weighted average for a period of at least ninety (90) consecutive days, then, commencing on the 91st day, the price shall be the highest price so posted for more than ninety (90) consecutive days. This price shall remain in effect so long as it remains highest and higher than the average. Thereafter the price shall revert to the price as determined by subparagraph (a).

(c) If there is no posted price for a crude oil in a field from which crude oil is sold, the price for that crude oil shall be the price determined in accordance with subparagraph (a) for similar crude oil from the nearest field in California, with adjustment for gravity in accordance with prevailing practice in the industry at the time and place.

3. *Delivery*—If appropriate based on the location of the crude oil and the buyer's refinery, through Getty's or Texaco's existing pipelines on conditions similar to conditions in December 1983. Transportation fees shall be the fees levied for Getty's most recent arrangement in effect in December 1983 for comparable transportation, adjusted for the Fuels and Related Products and Power Index, Part of Producer Prices and Price Index, U.S. Department of Labor, Bureau of Labor Statistics. Provided that the fees may include a reasonable return on any new investment to expand the capacity or extend the length of the pipelines.

4. *Volume per year*—To be determined in accordance with the terms of the contracts in effect in 1983. However, if the contracts permit the seller more than 20 percent flexibility in the volume to be delivered, the minimum volume shall be 80 percent of the maximum volume specified in the contracts. If the contracts do not specify volume or if no contracts exist, the volume per year shall be the volume delivered in 1983. Provided, however, that in no event shall the volume specified by the provision exceed those actually delivered in 1983.

If any customer of Getty should take less than the volume of crude oil that Texaco is required to offer, the customer's future rights are proportionally reduced but Texaco shall make such volume available for sale, under the terms and conditions set out herein, to all companies that have refineries located in California and that had a total refining capacity worldwide of less than 100,000 barrels/day in December 1983.

5. *Practicality*—Texaco shall not be required to deliver crude oil to the extent that Texaco's production has ceased or been reduced. However, any volumes not sold because production has ceased or been reduced shall be sold to the buyer on the same terms and conditions when production recommences, even after July 1, 1989.

Either party may cease or reduce production or purchases if the party would otherwise sustain continuing operating losses (excluding fixed capital or investment costs) in the production or refining of the crude oil under the terms and conditions set out herein. The party sustaining continuing operating losses shall provide thirty (30) days notice to the other party to the contract and shall provide the other party the opportunity to renegotiate the contract on more economic terms. Any dispute as to whether any party is sustaining continuing operating losses or whether any offer fully compensates for such losses and provides a reasonable profit (excluding profits on fixed capital or investment) shall be submitted to binding arbitration.

6. *Arbitration*—Any dispute between Texaco and any buyer shall be settled by binding arbitration. If the parties are unable to agree on an arbitrator, the dispute shall be settled pursuant to the commercial arbitration rules of the American Arbitration Association.

7. *Other*—The contract will be subject to force majeure and other customary terms to be negotiated, consistent with terms customary in the industry.

Schedule C—Getty Northeast Properties

Withheld Properties

Massachusetts

1 Powder Mill Rd., c/o, Maynard, MA.
1060 Old Conn. Path, c/o, Framingham, MA.
221 Main St., c/o, Gardner, MA.
245 N. Main St., c/o, Randolph, MA.
609 Park Ave., c/o, Worcester, MA.
671 Washington St., co/LL, Quincy, MA.
437 High Plain St., L/B, Walpole, MA.
835 Rockdale Ave., c/o, New Bedford, MA.
150 Plymouth Ave., c/o, Fall River, MA.
964 Boylston St., c/o, Newton, MA.
346 Sea St., L/b, Quincy, MA.

Connecticut

156 Boston Post Rd., co/LL, Waterford, CT.

Rhode Island

33 Jefferson Blvd., c/o, Warwick, R.I.
1307 Post Rd., c/o, Warwick, R.I.
1069 Warwick Ave., c/o, Warwick, R.I.
772 Willett Ave., c/o, E. Providence, R.I.
495 Tower Hill Rd., c/o, E. Kingston, R.I.
2501 W. Shore Rd., L/B, Warwick, R.I.

New York

1128 E. Gun Hill Rd., co/LL, Bronx, N.Y.
1133 Jerome Ave., L/B, Bronx, N.Y.
1740 Jerome Ave., L/B, Bronx, N.Y.
1881 Forest Ave., c/o, Staten Island, N.Y.
1124 First Ave., L/B, New York, N.Y.
1981 Ocean Ave., L/B, Brooklyn, N.Y.
920 Hylan Blvd., L/B, Staten Island, N.Y.
29-15 College Pt. Blvd., L/B, New York, N.Y.
152 10th Ave., L/B, New York, N.Y.
571 Coney Island Ave., L/B, Brooklyn, N.Y.

New Jersey

350 Preakness Ave., c/o, Paterson, N.J.
Rt. 30 McLean Blvd., c/o, Paterson, N.J.
132 Rt. 46, c/o, Budd Lake, N.J.
Rt. 9 and Locust St., c/o, Lakewood, N.J.
Rt. 88 (South Side), c/o, Bricktown, N.J.
551 W. Front St., c/o, Plainfield, N.J.
1650 Lincoln Hwy (Rt. 27) c/o, Edison Twnp., N.J.
1121 St. George Ave., c/o, Woodbridge, N.J.
Sicklerville and Andrews Rd., co/LL, Winslow Twnp., N.J.
2031 Rt. 22 (Westbd), co/LL, Union, N.J.
White Horse Pk and Franklin, co/LL, Berlin, N.J.
45 French St., co/LL, New Brunswick, N.J.
Rt. 130 and Willow Dr., L/b, Cinnaminson, N.J.
County Line Rd., L/b, Jackson Twp., N.J.
Delsea Drive, L/b, Deptford Park, N.J.
Rt. 20 North, L/b, Paterson, N.J.
Rt. 35 and Poole Ave., L/b, Hazlet, N.J.
Rt. 22 (East), L/b, Hillside, N.J.
Middlesex and Main St., L/b, Metuchen, N.J.
2352 Morris Ave., c/o, Union, N.J.
Egg Harbor Rd., c/o, Washington, N.J.
738 Cedar Land, L/b, Teaneck, N.J.
2284 Rt. No. 4, c/o, Fort Lee, N.J.

Pennsylvania

Hunt Pk and Clearfield, c/o, Philadelphia, PA.
6900 Frankford Rd., c/o, Philadelphia, PA.
Rt. 29 and Chestnut St., c/o, Emmons, PA.
3024 New Rogers Rd., c/o, Bristol Twnp., PA.
Albright and Tilghman, c/o, Allentown, PA.
U.S. 202 and PA Trnpk., c/o, King of Prussia, PA.
Bustleton and Buck Rds., c/o, Feasterville, PA.

Maryland

121 South Bond St., c/o, Bel Air, MD.
149 Back River Rd., c/o, Baltimore, MD.
Oakleigh Rd., L/b, Parkville, MD.

Before Federal Trade Commission

Complaint

In the Matter of Texaco Inc., a corporation, and Getty Oil Company, a corporation.

The Federal Trade Commission, having reason to believe that respondent, Texaco Inc., a corporation subject to the jurisdiction of the Federal Trade Commission, intends to acquire, or has acquired the stock of assets of respondent Getty Oil Company, in violation of Section 7 of the Clayton Act, as amended (15 U.S.C. Section 18), and Section 5 of the Federal Trade Commission Act, as amended (15 U.S.C. Section 45), and that a proceeding in respect thereof would be in the public interest, hereby issues its complaint, pursuant to Section 11 of the Clayton Act (15 U.S.C. Section 21) and Section 5(b) of the Federal Trade Commission Act (15 U.S.C. Section 45(b)), stating its charges as follows:

I Definitions

1. For purposes of this complaint, the following definitions shall apply:

a. "Texaco" means Texaco Inc., its predecessors, subsidiaries, divisions, groups, affiliate entities, and each [illegible] their past or present directors, officers, employees, agents, and representatives, and each partnership, joint venture, joint stock company or concession in which Texaco is a participant. The words "subsidiary," "affiliate" and "joint venture" refer to any partial (10 percent or more) as well as total ownership or control.

b. "Getty" means Getty Oil Company, its predecessors, subsidiaries, divisions, groups, affiliate entities, and each of their past or present directors, officers, employees, agents and representatives; and each partnership, joint venture, joint stock company or concession in which Getty is a participant. The words "subsidiary," "affiliate" and "joint venture" refer to any partial (10 percent or more) as well as total ownership or control.

c. "The acquisition" means the transaction described, in whole or in part, in paragraph 14 of this Complaint.

d. "Aviation gasoline" means that product as defined in connection with Department of Energy Form EIA-810, Monthly Refinery Report, product code 111.

e. "Gasoline" means motor gasoline as defined in connection with Department of Energy Form EIA-810, Monthly Refinery Report, product codes 132 and 133.

f. "Jet fuels" means naptha-type and kerosene-type jet aircraft fuel, as defined in connection with Form EIA-810, Monthly Refinery Report, product codes 211 and 213.

g. "Middle Distillates" means the products commonly known as number one fuel oil (kerosene), and number two fuel oil (home heating, diesel) as defined in connection with Department of Energy Form EIA-810, Monthly Refinery Report, product codes 311 and 411.

h. "Refined light products" means aviation gasoline, gasoline, jet fuels, and middle distillates.

i. "Heavy crude oil" means crude oil below 20 API gravity.

j. "Terminal" means a facility used for receipt, storage, and distribution of gasoline, middle distillates, or jet fuel, and which receives product directly via pipeline, navigable waterway or from an adjacent refinery.

II. Respondents

A. Texaco

2. Respondent Texaco is a corporation organized and doing business under the laws of the state of Delaware with its executive offices at White Plains, New York.

3. Respondent Texaco is a fully integrated petroleum company, engaged in the exploration for and production of crude oil and natural gas, refining the transportation of crude oil, natural gas and refined products, and the distribution and marketing of refined products and natural gas.

4. In 1982, respondent Texaco had revenues of about $48 billion, assets of about $27 billion, and net income of about $1.28 billion.

5. In 1982, respondent Texaco ranked sixth in the United States in crude oil production, eighth in domestic crude oil reserves, fifth in refining capacity, and fourth in gasoline sales.

6. Respondent Texaco has refineries located at Wilmington, California; Lawrenceville, Illinois; Convent, Louisiana; Westville, New Jersey; Port Arthur, Texas; Port Neches, Texas; Amarillo, Texas; El Paso, Texas; and Anacortes, Washington, with a combined refining capacity of 937 thousand barrels per day. In 1982, Texaco sold its refineries in West Tulsa, Oklahoma and shut down its refinery in Casper, Wyoming.

7. At all times relevant herein, respondent Texaco has been and is now engaged in commerce as "commerce" is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. Section 12, and is a corporation whose business is in or affecting commerce as "commerce" is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. Section 44.

B. Getty

8. Respondent Getty is a corporation organized and doing business under the laws of the state of Delaware with its executive offices at Los Angeles, California.

9. Respondent Getty is a fully integrated petroleum company, engaged in the exploration for and production of crude oil and natural gas, refining, the transportation of crude oil, natural gas and refined products, and the distribution and marketing of refined products and natural gas.

10. In 1982, respondent Getty had revenues of about $12.3 billion, assets of about $9.9 billion, and net income of about $692 million.

11. In 1982, respondent Getty ranked 10th nationally in crude oil production, 6th in United States crude oil reserves, 18th in United States refining capacity, and 16th in United States motor gasoline sales.

12. Respondent Getty has refineries located at Bakersfield, California; Delaware City, Delaware; and El Dorado, Kansas, with a combined refining capacity of about 278 thousand barrels per day.

13. At all times relevant herein, respondent Getty has been and is now engaged in commerce as "commerce" is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. Section 12, and is a corporation whose business is in or affecting commerce as "commerce" is defined in Section 4 of the Federal Trade Commission Act, as amended, 15 U.S.C. Section 44.

III. The Acquisition

14. On January 9, 1984, Texaco commenced a tender offer for 35 percent of Getty voting securities with the intention of effectuating a follow-up merger for the remaining outstanding shares; and on January 6, 1984, Texaco and Getty entered into a merger agreement pursuant to which Getty granted Texaco an option to purchase authorized but unissued shares constituting approximately 10.2 percent of the total Getty shares that would be outstanding after such issuance. Further, on or about January 6, 1984, and January 8, 1984, Texaco entered into agreements to purchase voting securities constituting approximately 11.8 percent and 40.2 percent, respectively, of the outstanding Getty shares. The total value of the transaction is about $10.1 billion and, if consummated, would result in the second largest petroleum company in the United States in terms of assets.

IV. Trade and Commerce

A. Manufacturer of Refined Light Products in the Northeast United States

15. One relevant line of commerce in which to evaluate the effects of the acquisition is the manufacture of refined light products.

16. The relevant section of the country is the Northeast region, composed of Maryland, Delaware, eastern Pennsylvania, New Jersey, eastern New York, Connecticut, Rhode Island, Massachusetts, New Hampshire, Vermont and Maine, and any submarket thereof. This relevant section of the country also includes the United States possession of the Virgin Islands.

17. The manufacture of refined light products in the relevant section of the country is moderately concentrated.

18. Respondents Texaco and Getty are actual competitors of each other and of other firms in the manufacture of refined light products in the relevant section of the country. Respondent Texaco owns a refinery in Westville, New Jersey, that manufactures refined light products. Respondent Getty owns a refinery in Delaware City, Delaware, that manufactures refined light products.

19. Refineries in the Northeast region have a locational advantage over Gulf Coast refineries in the supply of refined light products to the relevant section of the country.

20. Refineries in the Gulf Coast area are unlikely to be able to expand

substantially, and within a reasonable period of time, shipments of refined light products to the relevant section of the country on Colonial Pipeline due to the likelihood of capacity constraints on the pipeline.

21. Foreign imports of refined light products into the relevant section of the country are unlikely within a reasonable period of time to provide substantial competition to the manufacturers of refined light product in the relevant section of the country.

22. Conditions of entry into the manufacture of refined light products in the relevant section of the country are difficult.

23. Texaco's incentives concerning the level of prices and outputs of refined light products in the relevant section of the country are affected by Texaco's share of refining capacity in the Northeast region, Texaco's share of refined light product supply into the Northeast region, Texaco's ownership share of Colonial Pipeline, and Texaco's level of shipments into the Northeast region on Colonial Pipeline.

B. Transportation of Refined Light Products

24. One relevant line of commerce in which to evaluate the effects of the acquisition is long distance transportation of refined light petroleum products into consuming regions. Within this market, petroleum product pipelines represent another relevant line of commerce.

25. One relevant section of the country is the Northeast region composed of Maryland, Delaware, eastern Pennsylvania, New Jersey, eastern New York, Connecticut, Rhode Island, Massachusetts, New Hampshire, Vermont, and Maine.

26. Another relevant section of the country is the State of Colorado.

27. Transportation of refined petroleum products into the relevant sections of the country is highly concentrated.

28. Refinery capacity for refined light products in the State of Colorado is not adequate to meet demand and substantial amounts of refined light products are transported into the State of Colorado.

29. There are four pipelines capable of transporting refined light products into the State of Colorado: The Wyco Pipe Line; The Medicine Bow Products Pipeline System; the Chase Pipe Line; and a pipeline owned by Phillips and Diamond Shamrock that runs from Borger, Texas, to Aurora, Colorado, near Denver.

30. The Wyco Pipe Line is jointly owned by Texaco (40 percent), Amoco (40 percent), and Mobil (20 percent). The South Line of the Wyco Pipe Line runs from Cheyenne, Wyoming through Denver, Colorado, and terminates in Colorado Springs, Colorado.

31. The Chase Pipe Line is owned by Getty (50 percent) and Koch Oil Company (50 percent). It runs from El Dorado, Kansas to the Denver, Colorado area.

32. Texaco's incentivies with respect to the level of tariffs on the Wyco Pipe Line and Chase Pipe Line are affected by Texaco's ownership share of pipelines capable of transporting refined light product into the State of Colorado.

33. Refinery capacity for refined light products in the Northeast region is not adequate to meet demand for refined light products in this relevant section of the country. The Colonial Pipeline is the dominant means of transporting additional refined light products into the Northeast region, supplying approximately 36.9 percent of total consumption of refined light products in the relevant section of the country in 1982. Four firms (Texaco, Gulf, Amoco, and CITGO Pipeline Investment Company) account for approximately 59.35 percent of ownership of the Colonial Pipeline.

34. Conditions of entry into the business of the transportation of refined light products by pipeline into the relevant sections of the country are difficult.

35. Respondents Texaco and Getty are actual competitors of each other and of other firms in the transportation of refined light products in the Northeast region. Respondent Texaco holds an ownership share of about 14.3 percent of the Colonial Pipeline. Respondent Getty owns 100 percent of the Getty Eastern Products Pipeline.

36. Tariff rates on the Colonial Pipeline are set by action of the Colonial Board of Directors.

37. Texaco's incentives concerning the level of tariffs on the Colonial Pipeline and expansion of the Colonial Pipeline are affected by Texaco's ownership share of Colonial Pipeline, Texaco's level of shipments on the Colonial Pipeline, Texaco's refining capacity in the Northeast region, and Texaco's share of petroleum product supply in the Northeast region.

C. Marketing of Gasoline and Middle Distillate

38. One relevant line of commerce in which to evaluate the effects of the acquisition is the wholesale distribution of gasoline and middle distillate and submarkets thereof.

39. The relevant sections of the country are the areas served by terminal clusters in or near the following cities and areas:

a. New Haven, Connecticut
b. Portland, Maine
c. New York City, New York
d. The Delaware River Valley
e. Providence, Rhode Island
f. Colorado Springs, Colorado
g. The Delmarva Peninsula.

40. The wholesale gasoline and middle distillate markets described in paragraphs 38 and 39 are concentrated with subsantial shares of wholesale gasoline and middle distillate sales in each of the relevant sections of the country accounted for by respondents Texaco and Getty.

41. Conditions of entry into the wholesale distribution of gasoline and middle distillate are difficult.

42. Respondents Texaco and Getty are actual competitors of each other and of other firms inthe wholesale distribution of gasoline and middle distillate in the relevant sections of the country. The combination of Texaco and Getty would increase the levels of concentration and combine their shares in the relevant sections of the country.

43. Texaco's incentives concerning the level of prices and output of gasoline and middle distillate sold from terminals and the price of and access to available terminal facilities are affected by Texaco's share of terminal capacity within each terminal cluster.

D. Sale, Transportation and Refining of California Heavy Crude Oil Into Petroleum Products

44. One relevant line of commerce in which to evaluate the effects of the acquisition is the sale of heavy crude oil.

45. Another relevant line of commerce in which to evaluate the effects of the acquisition is the transportation of crude oil through pipelines including trunk lines and gathering lines.

46. For the sale and transportation of crude oil, one relevant section of the country is the State of California.

47. Another relevant line of commerce in which to evaluate the effects of the acquisition is the refining of crude oil into petroleum products.

48. For the refining of crude oil into petroleum products, one relevant section of the country is the West Coast of the United States, extending from the State of California to the State of Washington.

49. Concentration in the relevant markets is high and entry conditions are difficult.

50. Both Getty and Texaco own refiners in the relevant market. Getty owns a refinery in Bakersfield, California. Texaco owns a refinery in

Wilmington, California and Anacortes, Washington.

51. Getty produces substantially more heavy crude oil than it can refine on the West Coast.

52. Texaco produces substantially less heavy crude oil than it can refine on the West Coast.

53. Texaco owns and operates a proprietary pipeline system to gather heavy crude oil in the San Joaquin Valley of California.

54. Getty owns and operates a proprietary pipeline system that gathers heavy crude oil in the San Joaquin Valley and transports heavy crude oil from Bakersfield to the San Francisco area.

55. Texaco's West Coast refineries compete with the refineries of non-integrated refiners.

56. Texaco has an incentive to increase its refining of heavy crude oil and to lessen competition from non-integrated refiners.

57. The acquisition of Getty is likely to increase Texaco's incentives and ability to deny non-integrated refiners heavy crude oil and access to proprietary pipelines.

V. Effects

58. The effect of the acquisition may be substantially to lessen competition or tend to create a monopoly in each of the relevant lines of commerce and relevant sections of the country in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. 45, in the following ways, among others:

a. Actual competition between respondents Texaco and Getty in the relevant lines of commerce and relevant sections of the country will be eliminated; and

b. Actual competition between competitors generally in the relevant lines of commerce and relevant sections of the country will be lessened.

59. The effect of the acquisition may be substantially to lessen competition or tend to create a monopoly in the relevant lines of commerce and relevant sections of the country in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. 18, and section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. 45, in the following additional ways, among others:

a. Texaco may have the incentive and ability to and may raise price and restrict output of refined light products from its Northeast region refining capacity because the acquisition increases Texaco's share of refining capacity in and pipeline capacity into the Northeast region, and increases Texaco's share of refined light product supply in the Northeast region.

b. Texaco may be likely to support and secure a higher level of tariffs on the Colonial Pipeline and oppose expansion of the Pipeline because the acquisition increases Texaco's refining capacity in the Northeast, increases Texaco's share of petroleum product supply in the Northeast, and decreases Texaco's relative shipment requirements on the Colonial Pipeline.

c. Texaco may be likely to support and secure a higher level of tariffs on the Wyco Pipe Line and Chase Pipe Line because the acquisition increases Texaco's share of pipeline capacity in the State of Colorado and increases its share of refined light product supply in the State of Colorado.

d. Control by Texaco of Getty's marketing operations is likely to reduce price competition in gasoline and middle distillate marketing provided by Getty and by independent private brand marketers previously supplied by Getty in the relevant sections of the country.

e. Texaco may have the incentive and ability to and may raise price levels and restrict output from gasoline and middle distillate terminals and raise the level of price and limit access to available terminal facilities in certain terminal clusters because the acquisition will increase Texaco's share of terminal capacity in these terminal clusters.

f. For reasons unrelated to the efficient use of resources, Texaco may have the incentives and ability to and may deny access to heavy crude oil and to proprietary pipeline transportation to non-integrated refiners, thereby increasing the difficulty of entry into West Coast refining, decreasing the competitive significance of non-integrated West Coast refiners, and increasing concentration in West Coast refining.

VI. Violation Charged

60. The proposed acquisition of the stock and assets of Getty by Texaco, as set forth in paragraph 14 herein, if consummated, would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. 45.

Wherefore, the premises considered, the Federal Trade Commission on this — day of —, A.D. 1984, issues its complaint against respondents Texaco Inc. and Getty Oil Company.

Before Federal Trade Commission

[File No. 841-0077]

Agreement To Hold Separate

In the Matter of Texaco Inc., a corporation, and Getty Oil Company, a corporation.

Agreement dated as of February 13, 1984, (the "Agreement"), by and between Texaco Inc., ("Texaco"), a corporation organized and existing under the laws of Delaware, whose executive offices are located at 2000 Westchester Avenue, White Plains, New York, 10650 and the Federal Trade Commission (the "Commission"), an independent agency of the United States Government, established under the Federal Trade Commission Act of 1914, 15 U.S.C. 41 *et seq.* (collectively, the "Parties").

Premises

Whereas, Texaco commenced on January 9, 1984 a tender offer for at least 28,000,000 shares of Getty with the intention of effectuating a follow-up merger for the remaining outstanding shares pursuant to a merger agreement entered into by Texaco and Getty and January 6, 1984; and on January 6, 1984, Texaco and Getty also entered into a Stock Option Agreement pursuant to which Getty granted Texaco an option to purchase 9,000,000 authorized but unissued shares, constituting approximately 10.2 percent of the Shares that would be outstanding after such issuance.

Further, on January 6, 1984, prior to the execution of the merger agreement, Texaco and the J. Paul Getty Trust (the "Museum") entered into a Stock Purchase Agreement pursuant to which Texaco has purchased in escrow pending antitrust clearance 9,320,340 Shares, constituting approximately 11.8 percent of the outstanding Shares, from the Museum.

On January 8, 1984, Texaco and Gordon P. Getty, as Trustee of the Sarah C. Getty Trust dated December 31, 1934, entered into a Stock Exchange Agreement pursuant to which Texaco has agreed to purchase 31,805,088 Shares, constituting 40.2 percent of the outstanding Shares. (All of the above described transactions will be referred to as the "Acquisition").

Whereas, the Commission is now investigating the Acquisition to determine if the Acquisition would violate any of the statutes enforced by the Commission; and

Whereas, if the Commission accepts the attached Agreement Containing Consent Order ("Consent Order") the

Commission must place it on the public record for a period of at least sixty (60) days and may subsequently withdraw such acceptance pursuant to the provisions of § 2.34 of the Commission's Rules; and

Whereas, the Commission is concerned that if an understanding is not reached preserving the *status quo ante* of Getty's oil and gas assets and businesses during the sixty (60) day period or the acquisition in not preliminarily enjoined, and if the Commission subsequently withdraws acceptance of the Consent Order, divestiture resulting from any proceeding challenging the legality of the Acquisition might be a less than effective remedy; and

Whereas, Texaco's entering into this Agreement shall in no way be construed as an admission by Texaco or Getty that the Acquisition is illegal; and

Whereas, Texaco understands that no act or transaction contemplated by this Agreement shall be deemed immune or exempt from the provisions of the antitrust laws by reason of anything contained in this Agreement.

Now, therefore, the Parties agree, upon the understanding that the Commission has not yet determined whether the Acquisition will be challenged, and in consideration for the Commission's granting of early termination of the waiting periods prescribed under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. 18A, and the rules and regulations promulgated thereunder, 16 CFR Part 803, *et seq.*, upon Commission approval of this Agreement, and for the Commission's agreement that, unless the Commission determines to reject the Consent Order, it will not seek further relief from Texaco with respect to the Acquisition, except that specifically provided for in the Consent Order, as follows:

1. Texaco agrees to execute and be bound by the attached Consent Order.

2. During the term of this Agreement, Texaco agrees to hold Getty's oil and gas assets and businesses, as defined in 2(a), separate and apart on the following terms and conditions:

a. During the term of this Agreement, Getty's domestic crude oil, petroleum product, and gas exploration, production, processing, refining, transportation, and marketing activities, and similar foreign activities to the extent involved in imports into the United States ("oil and gas assets and businesses") shall be operated independently of Texaco.

b. Texaco shall not exercise direction or control over, or influence directly or indirectly, any of Getty's oil and gas assets and businesses. Provided, however, that Texaco may exercise such direction and control over Getty as is necessary to assure compliance with this Agreement.

c. Except as required by law and except to the extent that necessary information is exchanged in the course of evaluating the Acquisition, defending litigation, or negotiating agreements to dispose of assets, Texaco shall not receive or have access to, or the use of, any "material confidential information" relating to Getty's oil and gas assets and businesses not in the public domain. Any such information that is obtained pursuant to this subparagraph shall only be used for the purposes set out in this subparagraph. ("Material confidential information" as used herein means competitively sensitive or proprietary information not independently known to Texaco from sources other than Getty and includes, but is not limited to, customer lists, price lists, marketing methods, seismic data, patents, technologies, processes or other trade secrets.)

d. Texaco will not change the composition of the management of Getty's oil and gas assets and businesses except that the "Current Board" (as defined in paragraph 4) shall have the power to remove employees for cause; nor shall Texaco sell, transfer or encumber or otherwise impair the marketability or viability of Getty's oil and gas assets and businesses (other than in the normal course of business or pursuant to paragraph 6).

e. All material transactions, out of the ordinary course of business and not precluded by paragraphs 2(a)–(d), shall be subject to a majority vote of the "Board" (as defined in paragraph 4).

3. For the purpose of determining or securing compliance with this Agreement, subject to any legally recognized privilege, and upon written request with reasonable notice to Texaco or Getty made to its principal office, Texaco and Gety shall permit any duly authorized representative or representatives of the Commission:

a. Access during the office hours of Texaco or Getty, in the presence of counsel, to inspect and copy all books, ledgers, accounts, correspondence, memoranda, and other records and documents in the possession or under the control of Texaco or Getty relating to compliance with this agreement.

b. Upon five (5) days notice to Texaco or Getty and without restraint or interference from them, to interview officers or employees of Texaco or Getty, who may have counsel present, regarding any such matters.

No information or documents obtained by the Commission shall be divulged by any representative of the Commission, except in the case of legal proceedings to which the Commission is a party, or for the purpose of securing compliance with this Consent Order, or as otherwise required by law.

If, at the time information or documents are furnished by Texaco and Getty, Texaco or Getty identify same as "Confidential," then the Commission shall provide to Texaco and Getty ten (10) days notice or, if ten (10) days is not possible, as many days notice as possible prior to divulging such material in any legal proceeding to which that entity is not a party.

4. Texaco may adopt articles of incorporation and by-laws (provided they are not inconsistent with other provisions of this agreement) and may elect a new Board of Directors of Getty ("Board") once it is a majority shareholder of Getty. Texaco may elect any number of directors to the Board. Provided, however, that such Board shall consist of at least six (6) current Getty directors ("Current Board") and no more than two (2) Texaco employees or agents and four (4) outside Texaco directors. Directors of Getty who are directors, employees or agents of Texaco and who receive in their capacity as directors of Getty material confidential information relating to Getty's oil and gas assets and businesses shall not disclose such information to Texaco or use it to obtain any advantage for Texaco.

5. The Board may transfer the properties described in Schedule A of the Consent Order ("Schedule A properties") into a wholly-owned Getty subsidiary or division.

6. Nothing herein shall prevent the Board (for Texaco until it becomes a majority shareholder of Getty) from negotiating or entering into agreements to dispose of Getty's assets, provided that any such agreements with respect to oil and gas related assets and businesses are conditioned on and not consummated prior to final approval by the Commission of the Consent Order and are in compliance with the Consent Order.

7. Nothing contained in this Agreement shall be construed to limit the sale of Getty's non-petroleum related assets by majority vote of the full Board. Texaco shall have the right to borrow all proceeds from any such sale in exchange for an interest bearing note (calculated at the General Motors Acceptance Corporation short term thirty (30) day rate) made payable to Getty and falling due fourteen (14) days

after any denial of final approval of the Consent Order by the Commission.

8. A majority of the Board may declare a dividend payment no greater than the amount paid in the same quarter in 1983. Except for such dividend payment, all earnings and profits of Getty shall be retained separately in Getty. Texaco shall have the right to borrow monies from Getty upon approval by a majority of the Board on the same terms and conditions as described in paragraph 7; provided, however, Texaco shall not borrow funds if the result would be to impair Getty's ability to operate its oil and gas assets and businesses at its 1983 levels of expenditure on an annualized basis.

9. Except where there are existing Getty contracts, Texaco agrees to offer to sell Getty California crude oil to all December 1983 or January 1984 Getty customers in accordance with terms and conditions set out in paragraph V of the Consent Order (except that the term shall include the period from the date Texaco becomes a majority shareholder of Getty and elects a new Getty Board until final acceptance of the Consent Order by the Commission.)

10. Texaco agrees to offer access to Getty's pipeline from Santa Fe Springs to Los Angeles in accordance with the terms and conditions set out in paragraph VI of the Consent Order (except that the term shall include the period from the date Texaco becomes a majority shareholder of Getty and elects a new Getty Board until final acceptance of the Consent Order by the Commission).

11. Should the Federal Trade Commission seek in any proceeding to compel Texaco to divest itself of the shares of Getty stock it shall acquire, or to compel Texaco or Getty to divest themselves of any assets that may be held by either company, or to seek any other injunctive or equitable relief, neither Texaco nor Getty shall raise an objection based upon the expiration of the applicable Hart-Scott-Rodino Antitrust Improvements Act waiting periods or the fact that the Commission has permitted the Getty stock to be acquired and a formal merger concluded pursuant to the terms of this Agreement. Texaco also waives all rights to contest the validity of this Agreement.

12. This Agreement will terminate on the earlier of:

a. The date on which the Commission finally approves the Consent Order or three (3) business days after it withdraws its acceptance of the Consent Order pursuant to the provisions of § 2.34 of the Commission's Rules; or

b. 120 days after publication in the Federal Register of the Consent Order at Texaco's option.

Provided, however, that if the Commission finally approves the Consent Order, this Agreement will continue to pertain to the Schedule A properties of Getty until Texaco divests the Schedule A properties.

13. This Agreement shall not be binding until approved by the Commission.

Analysis of Proposed Consent Order To Aid Public Comment

The Federal Trade Commission has provisionally accepted an agreement containing a proposed consent order with Texaco Inc.

On February 13, 1984, the Commission entered into a consent agreement with Texaco in settlement of a proposed complaint. The proposed complaint states that the Commission has reason to believe that consummation of Texaco's acquisition of the Getty Oil Company ("Acquisition") would violate Section 7 of the Clayton Act and Section 5 of the Federal Trade Commission Act. The complaint specifically alleges that the Acquisition may substantially lessen competition in several markets: (1) The manufacture and transportation of "refined light products" (distillate fuel oil, aviation gasoline, gasoline, jet fuels, and kerosene) in the northeastern United States; (2) the wholesale distribution of gasoline and middle distillates (home heating oil and diesel fuel) to retailers in a number of cities and areas in the northeastern United States; (3) the pipeline transportation of refined light product into the state of Colorado; and (4) the sale, pipeline transportation, and refining into petroleum products of heavy crude oil in the state of California.

To remedy these alleged anticompetitive results of the Acquisition, the proposed consent order negotiated with Texaco and provisionally accepted by the Commission would require Texaco (among other things) to: (a) "Divest" (sell) certain of Getty's petroleum-related assets in the northeastern United States; (b) divest a Texaco refinery located in the Northeast; (c) vote to expand (for 10 years) a major refined product pipeline that supplies the Northeast and of which Texaco is a co-owner; (d) divest certain Getty petroleum assets in specified Rocky Mountain, midwestern, and southwestern states; and (e) supply certain independent California refiners with Getty crude oil, on specified terms for set time periods.

The Commission has placed the proposed consent order on the public record for sixty (60) days so that interested parties may comment on it. Comments received during this period will become part of the public record, unless commentors request confidential treatment. After sixty (60) days, the Commission will review the consent agreement and the comments received and will decide whether it should withdraw from the agreement or make final the agreement's proposed order. If the Commission withdraws from the agreement, it may: (1) Determine that no relief is required; (2) attempt to negotiate with Texaco any necessary modifications in the proposed consent order; or (3) initiate litigation to compel Texaco to divest certain assets or seek any other injuctive or equitable relief consistent with Section 7 of the Clayton Act or Section 5 of the Federal Trade Commission Act.

In addition to provisional acceptance of the proposed consent, the Commission has approved an "Agreement To Hold Separate" between Texaco and the Commission. This agreement will maintain the separate identity and individual viability of Getty's oil and gas assets during the public comment period. If, at the end of the comment period, the Commission believes further enforcement action is warranted and withdraws from the proposed consent agreement, under Section 13(b) of the Federal Trade Commission Act the Commission may seek a federal court order extending the hold separate provisions for the duration of any administrative proceeding to prevent any outsanding antitrust problems until a final adjudication of the issues occurs.

The purpose of this analysis is to facilitate the public comment on the proposed order. It is not intended to constitute an official interpretation of the proposed consent order or to modify in any way its terms. To further assist commentors, the Commission has also placed on the public record copies of a report summarizing the results of its recent, in-depth study of mergers in the petroleum industry.[1] That report discusses many of the competition issues raised by the Acquisition.

Paragraph I

The introductory paragraph of the proposed order defines the terms used in the order. Of particular importance, "Schedule A Properties" are defined to include the assets and businesses that are listed in the Schedule A appendix to the proposed consent order. The proposed order would require Texaco to divest those properties within twelve (12) months. The Schedule A Properties are: (1) Getty's petroleum-related assets in the northeastern United States, *excluding* Getty's Delaware City refinery and 30 of Getty's 1900 retail gasoline stations[1]; (2) Texaco's Eagle Point refinery located in New Jersey; and (3) Getty's crude oil and product pipeline, refining, and marketing assets located in specified Rocky Mountain, midwestern, and southwestern states.

---

[1] Report of the Federal Trade Commission, *Mergers in the Petroleum Industry* (1982) (hereafter "*Merger Study*").

Paragraphs II and IV

Paragraph II of the proposed order provides the terms and conditions for selling the Schedule A Properties. Texaco would be required to divest the properties within twelve (12) months; purchasers are subject to the prior approval of the Commission. Under the Commission's rules, applications for such prior approval of proposed divestitures are placed on the public record for a separate, 30-day public comment period. If any of the properties were not sold within the 12 months, Texaco would consent to the appointment of a trustee to divest the properties. The trustee would have eighteen (18) months to divest the properties or to submit a divestiture plan, subject to Commission approval.

Paragraph IV of the proposed consent requires Texaco, for a 10-year period, to vote to expand Colonial Pipeline. Texaco is a co-owner of Colonial, which carries refined light products from the Gulf Coast to the Northeast and regions in between.

These divestiture and voting requirements are designed to remedy a number of different potential competitive problems, discussed below.

Wholesale Distribution of Gasoline and Middle Distillates in the Northeast

Under Schedule A(1), Texaco would have to divest Getty's wholesale distribution assets in the Northeast. Section IV(C) of the proposed complaint alleges that the Acquisition may tend to lessen competition in the wholesale distribution of gasoline and middle distillates in six areas in the Northeast (as well as one in Colorado). "Wholesale distribution" as used in the proposed complaint means sales from petroleum product "terminals" rather than bulk cargo sales at the refinery or retail sales. These terminals store petroleum products received from pipelines or waterborne vessels and dispense the products into tank trucks for further distribution. The wholesale market includes an identifiable set of services including storing, transporting, and dispensing of petroleum products from these terminals.

The relevant geographic markets for wholesale marketing appear to depend on the location of terminals and the distance that gasoline or middle distillates may be shipped economically from these terminals. Terminals tend to cluster in or near urban centers. The areas served by each of these clusters are generally smaller than a state but larger than a city. One cluster of terminals is often not in competition with other terminal clusters because the cost of trucking product from one cluster to another may be prohibitive. Texaco confirms that a geographic market may be defined by taking the location of terminals and determining how far product can be transported economically.[3]

Employing the terminal-cluster concept, the Commission considered a number of markets where concentration would increase appreciably as a result of the Acquisition. Based on wholesale gasoline *sales*, the Herfindahl-Hirschman Index ("HHI")[4] would increase in certain areas as follows: Portland, Maine—112; Providence, Rhode Island—190; New Haven, Connecticut—138; New York, New York—151; Philadelphia, Pennsylvania—157; the Delmarva Peninsula—504.[5] Concentrations may also be measured based on terminal capacity for gasoline and middle distillates. As a result of the acquisition, the HHI for terminal *capacity* would apparently increase in certain areas as follows: Portland, Maine—the change in the HHI would be 195, with a post-acquisition HHI of 1483; Providence, Rhode Island—81 with a post-acquisition HHI of 1936; New York City—76 with a post-acquisition HHI of 2658.[6]

Some studies of wholesale gasoline marketing suggest a relationship between prices and concentration.[7] To remedy any greater likelihood of collusion or other potential anticompetitive effects that may result from such increases in concentration, paragraph II and Schedule A(1) of the proposed consent would require Texaco to divest Getty's Northeast marketing properties, including terminals, storage tanks, and retail stations (and, under Schedule A(2), additional marketing properties remedying any anticompetitive impact in Colorado Springs).

The retail stations are included in the Schedule A(1) divestiture package solely to assure the continued viability of Getty's Northeast wholesale operations after divestiture. On its own initiative, Texaco entered a contract to sell certain of these Northeast wholesale and retail assets to PowerTest, an independent gasoline marketer. The proposed consent requires prior Commission approval of any acquirer, including PowerTest. The Commission has not granted any such approval. If the proposed order is accepted finally, the Commission will decide whether to approve proposed acquirer(s) following a review of written comments submitted by interested persons during the separate, 30-day public comment period, discussed above.

---

[1] Texaco may retain 30 of the 81 Getty retail gasoline stations listed in the Schedule C appendix to the proposed consent order.

[3] Texaco Reply Brief at 6–7, Pennzoil v. Texaco Inc. and Getty Oil Company, No. 84–C–29–E (N.D. Okla.). Texaco also employs a terminal area pricing strategy, although prices may be varied on a more local basis. Texaco document.

This and additional citations to Texaco or Getty documents and data refer to confidential documents and data submitted to the Commission for the Commission's competitive review of the Acquisition. Texaco has waived confidential treatment for the limited purpose of permitting the Commission to cite relevant Texaco and Getty information and data in this Analysis.

[4] The Commission has found the HHI to be preferable to concentration ratios for analyzing market structure. One advantage of the index over traditional four-firm concentration ratios is that HHIs " 'reflect both the distribution of the market shares of the top four firms and the composition of the market outside the top four firms.' " *Grand Union et al.*, 3 Trade Reg. Rep. (CCH) ¶22,080 at 22,711 (July 18, 1983) *quoting* "Merger Guidelines of the Department of Justice," 2 Trade Reg. Rep. (CCH) ¶4500, 4503.10 (June 14, 1982) ("DOJ Merger Guidelines").

The HHI is calculated by summing the squares of the individual market shares of all firms. "DOJ Merger Guidelines" at ¶4503.10. To place in context the HHI estimates used in this Analysis, it is helpful to note that the Department of Justice has indicated that it is unlikely to challenge an acquisition where the post-acquisition HHI is below 1000. The Department is more likely than not to challenge an acquisition if the acquisition increases the HHI more than 100 points and the post-acquisition HHI is between 1000 and 1800. The Department is likely to challenge acquisitions that increase the HHI more than 50 points if the post-acquisition HHI is above 1800. *Id.* at ¶4503.101.

The Commission gives considerable weight to the "DOJ Merger Guidelines" in its evaluation of horizontal mergers and acquisitions. *See* "Statement of Federal Trade Commission Concerning Horizontal Mergers," Trade Reg. Rep. No. 546 (CCH) (June 14, 1982).

[5] Texaco and Getty data submitted in response to the Commission's Request for Additional Information under the Hart-Scott-Rodino Act of 1976 (hereafter "Response to Commission Request").

[6] Response to Commission Request.

[7] *See Merger Study* at 286, and studies cited therein. The Commission concluded that the "evidence may indicate the presence of market power in concentrated markets, but the interpretation of such evidence is fraught with difficulties." *Id.*

The Supply of Refined Light Products in the Northeastern United States

Section IV(A) of the proposed complaint alleges an anticompetitive effect in the manufacture of refined light products in the northeastern United States, as a result of the combination of Texaco's and Getty's refining capacity. Refineries in the Northeast region (accounting for almost half of all supply), Colonial Pipeline (about 38 percent of supply), coastal tanker movements (3–4 percent of supply), and imports (about 11 percent of supply) are the principal sources of refined light products in the Northeast market.

A. *Colonial Pipeline.* Because Colonial Pipeline contributes such a large percentage of total northeastern supply, an analysis of the full effect of the Acquisition in the Northeast market must consider Colonial. The pipeline runs from Texas to New Jersey. It transports refined light products manufactured in the Gulf Coast states into both the southeastern and northeastern United States. The pipeline is owned by ten refining companies. Six of these companies, including Texaco, operate refineries in the Northeast. The specific allegations concerning Colonial are set out in Section IV(B) of the proposed complaint.

The appropriate geographic market for antitrust analysis must consider how all these different sources of bulk suply of refined light product might affect a price increase initiated in the Northeast. For instance, if Colonial is operating well below capacity and pipeline "tariffs" (shipping rates) are constrained by regulation, any attempt by northeastern refiners to raise prices in the region might be defeated by Gulf Coast refiners shipping additional supplies through Colonial into the region. Under such circumstances, the Northeast would not be an appropriate geographic market for antitrust analysis.

However, if Colonial were at capacity or if Colonial's refiner-owners were able to raise substantially the pipeline's tariff, Gulf Coast refiners might not be able to ship sufficient product to nullify a price increase in the Northeast. Northern segments of Colonial Pipeline have, in fact, been at capacity during parts of 1980, 1981, 1982. Although the northern segment of Colonial is not at capacity now, an increase of 100–200 thousand barrels per day ("MBD") could create capacity problems in the winter months. This may depend upon the severity of the winter weather, general economic conditions, and the level of imports. It should be emphasized that many of the owners of Colonial also operate refineries in the Northeast. They may be unwilling to expand capacity or reduce tariffs in response to a price increase by northeastern refiners.

B. *Imports Into the Northeast.* If Colonial were at capacity, one alternative source of supply might come from tanker shipments from the Gulf Coast. However, tanker rates are substantially higher than the Colonial tariff even in the present depressed tanker market, and historically tankers have rarely offered rates below those of Colonial.[8] Industry sources also expect tanker rates to increase significantly by 1986 as a result of the U.S. Port and Tanker Safety Act.[9] Consequently, tankers from the Gulf Coast may not be able to provide the same kind of constraint against a Northeast price increase as a Colonial Pipeline operating at less than capacity.

Another potential constraint on price increases might be additional imports into the market. However, many Caribbean refineries may suffer a $4 to $6 per barrel disadvantage in landing products into the Northeast[10] and most Caribbean refineries have slowed production, concentrating on local demand.[11] Europe may be a source of some additional supplies should prices rise in the Northeast, but tanker costs from Europe are again substantially more expensive than shipments through Colonial.[12] Moreover, shipping product to the U.S. market from Europe is more expensive than shipping crude oil to refineries in the United States. In addition, European refiners may not be able to justify increasing production to supply the Northeast because it would require European refiners to also increase the production and sale of co-products, such as residual fuel oil, in a depressed market.

C. *Entry Into Refining.* One must also consider whether new entry into refining in the Northeast might restrain price increases. However, it would cost approximately $3.1 billion to build a state-of-the-art refinery in the Northeast.[13] And even if an appropriate site and funding could be obtained, the refinery construction must still be given a favorable environmental review by county, state, and federal agencies. From the beginning of the review process to the completion of the project is likely to consume at least four to six years. In part because of such difficulties, plans for 20 East Coast refineries have been cancelled in the last decade.[14]

D. *Analysis of Potential Competitive Problems.* If these alternative sources are not fully sufficient to prevent a price increase, Northeast consumers would have to depend upon supplies from Northeast refiners and through Colonial Pipeline. If Northeast refiners restricted output and if Colonial were a capacity and did not expand, these refiners might be able to sustain part of the price increase. Even if Colonial were not at capacity, a price increase might be sustainable if Colonial raised its tariff to match the price increase by Northeast refiners. Under a recent Federal Energy Regulatory Commission decision, petroleum product pipelines such as Colonial may have sufficient latitude to increase tariffs.[15]

Keeping all these factors in mind, there are a variety of ways of measuring the change in concentration that would result from the acquisition. These include the following extreme cases: (1) If we ignore the partial ownership of the Colonial Pipeline by northeastern refiners, but include all refined light products that are supplied to the Northeast by each company—Northeast refinery output, Colonial shipments, tankers from the Gulf Coast, and imports—the Acquisition results in a change in the HHI of only 80 points, with a post-acquisition HHI of 634; (2) if we assume that certain Colonial owners with Northeast refining capacity, including Texaco, could operate Colonial and their Northeast refining capacity to maximize joint profits and that they could form a voting coalition to block an expansion or possibily raise the tariffs of Colonial, the coalition could increase its control over refining capacity through Texaco's acquisition of the Getty refinery, resulting in an increase in the HHI of 522 points and a post-acquisition HHI of 3011.[16]

---

[8] Texaco document.

[9] 46 U.S.C.A. 3701–18. Under the U.S. Port and Tanker Safety Act, U.S. tankers must install segregated ballast and other safety equipment by 1986. To meet these requirements a majority of U.S. flag vessels will have to undergo extensive and costly retrofitting.

[10] Texaco document.

[11] Texaco document.

[12] Texaco document.

[13] Response to Commission Request.

[14] *See* Am. Petroleum Inst., "Trends in Refinery Construction in the United States," 38 (Sept. 16, 1980) (discussion paper #20).

[15] Williams Pipe Line Co., Dkt. No. OR-79-1-000, et al., 21 FERC section 61,160 (November 30, 1982). This decision is now on appeal. It is worth noting that Colonial estimated that it had a 20.22 percent return on equity for 1983. Texaco document. Colonial staff also believes that a 28 percent return on equity is reasonably supportable should the *Williams* decision stand. Texaco document. To obtain this higher return, Colonial Tariffs would have to be increased.

[16] Response to Commission Request and aggregated data from Form EIA-87, Energy Information Administration.

E. *Relief.* To relieve these potential competitive problems, paragraph II and Schedule A(3) of the proposed consent would require Texaco to divest its Eagle Point refinery in New Jersey. Because Texaco would retain Getty's larger Delaware City, Delaware refinery, Texaco's northeastern refining capacity (and its share of that market) would therefore increase somewhat as a result of the Acquisition. This increase in capacity may reduce Texaco's incentive to vote for an expansion of the Colonial Pipeline.[17] Accordingly, paragraph IV of the proposed consent would require Texaco to support all proposals to expand the Colonial Pipeline for a period of ten (10) years. Texaco would not be required to propose such expansions itself, but would be required to vote for any expansions proposed by any other owner of the pipeline or by the Colonial staff.

Pipeline Transportation of Refined Light Product Into Colorado

Under paragraph II and Schedule A(2) of the proposed consent order, Texaco would have to divest Getty's pipeline, refining, and marketing properties in a number of Rocky Mountain, southwestern and midwestern states. This divestiture would be responsive to Section IV(B) of the proposed Complaint, which alleges an overlap between Texaco and Getty in petroleum product pipeline ownership in Colorado.

There are only four pipelines capable of transporting refined light product into Colorado. Texaco owns 40 percent of one of these lines, Wyco Pipe Line, and Getty owns 50 percent of another, Chase Pipe Line. Of course, an appropriate market must include all available sources of supply. Thus, any measure of concentration must include local refineries with the four pipelines. As in the Colonial situation, market power over pipelines might be exercised though either blocking expansions or raising tariffs.

The measure of pipeline-refining concentration in the bulk supply of refined light products will depend upon the method used to attribute ownership shares of joint venture pipeline. Based on capacity (as opposed to actual sales) and treating the owners of joint venture pipelines as competitors, the Acquisition would increase the HHI by 179 points to 2202. At the other extreme, the Acquisition of Getty might be treated as a merger of the Wyco and Chase pipelines. This would lead to an increase in the HHI of 895 points to 2429.

It should be noted that Schedule A(2) of the proposed consent order requires a much broader divestiture than is require to remedy the competitive problem resulting from Texaco's increased ownership share of petroleum-product pipelines in Colordao. Divestiture of these related assets, includig the marketing and refining assets connected to the pipeline, appears necessary to assure that a viable competitive entity can be divested.

Paragraph III

Paragraph III of the proposed consent sets forth certain reporting requirements. Texaco would have to provide the Commission with detailed information on its progress in divesting the Schedule A Properties.

Paragraph V

Pursuant to paragraph V of the proposed order, Texaco would have to continue to offer to sell crude oil to certain California customers of Getty until mid-1989. The terms of the offer are provided in Schedule B. Any dispute that cannot be resolved would have to be settled by binding arbitration. If the parties are unable to agree on an arbitrator, the dispute shall be settled pursuant to the commercial arbitration rules of the American Arbitration Association.

The Sale, Transportation, and Refining of California Heavy Crude Oil Into Petroleum Product

Paragraph V is responsive to Section IV(D) of the proposed complaint, which alleges an anticompetitive affect resulting from the Acquisition in the sale, transportation, and refining into petroleum products of California heavy crude oil.[18] The problem arises because Getty owns substantial heavy crude oil reserves in California. This crude oil is denser (lower in gravity) than most crude oil produced in the world and often has a high nitrogen content. These characteristics make the crude more costly to refine. Getty has 17 percent of the production of such crude oil in the San Joaquin Valley of California, and about 140 MBD barrels per day production across the entire state.[19] Getty also has an extensive crude oil gathering and trunkline system capable of transporting heavy crude to California refineries. This includes a heavy crude oil trunkline with about 200 MBD in capacity, linking Bakersfield, California to San Francisco.

Getty's crude oil production is about 100 MBD in excess of the operating capacity of its one small refinery in California. Texaco, on the other hand, refines more crude than it produces on the West Coast, with production of only 33 MBD in California, compared to about 153 MBD in refining capacity in California and Washington.

At present, Getty is a substantial seller of heavy crude oil to "non-integrated" California refiners—i.e., refiners that are not also crude oil producers. These non-integrated refiners are to some degree tied to the California heavy crude oil market because of the substantial investment they have made to process this type of crude oil. If such refiners were forced to process lighter, more expensive crude oils, their investment in heavy crude oil processing equipment might no longer be economically viable.[20]

Non-integrated refiners face an additional problem in gaining access to heavy crude oil. Such crude oil is rarely produced anywhere elese in the world and is not imported. The refiners must therefore rely on California production. However, most California producers are tied to pipeline gathering systems that are privately-owned, which are in turn tied to trunkline systems that are also privately-owned. Unlike the systems in most states, California pipelines are not common carriers. Non-integrated California refiners are therefore not guaranteed access to much of the local crude oil production.

The above factual situation may have led to a "two-tier" market. Major gatherers may be able to "post" and buy crude oil at one price, while non-integrated refiners may be required to pay premiums above the posted price for the more limited supplies of crude oil available to them. (The posted price is the price at which major, integrated purchasers offer to buy crude oil from third parties, rather than the price at which sellers offer to sell crude oil to third parties.) For example, non-integrated refiners cite the $2–$3 per barrel premiums that they have offered for crude oil available from the Elk Hills Naval Petroleum Reserve in California. Texaco, with more refining capacity than West Coast crude production, is in fact one of the few major companies to bid at Elk Hills, winning 10 MBD of crude oil at $2.10 premium above the posted price.[21] Most major integrated oil companies have not participated at the Elk Hills' auctions, relying instead on their own production and purchases at the posted price.

---

[17] Texaco has in the past supported an expansion of the northern segment of Colonial Pipeline because some of its supplies for the Northeast are from its Gulf Coast refineries. Texaco could reduce waterborne shipments from the Gulf Coast after a Colonial expansion. Texaco document.

[18] The Commission determined that the Acquisition did not raise a danger of a substantial lessening of competition in other markets involving crude oil exploration, production, and sale.

[19] Response to Commission Request.

[20] The Commission has in the past recognized that West Coast crude oil product markets may be determined based on the gravity of the crude oils. *See Merger Study* at 150–51.

As a result of the acquisition, Texaco may have some incentives to divert the Getty heavy crude oil to its own refining system. This may be more profitable than selling the crude oil to others because of the crude oil Windfall Profit Tax Act of 1980.[22] A sale of the crude oil at a premium over the posted price might, in some situations, increase Texaco's Windfall Profit Tax liability. Alternatively, if Texaco were to process the crude oil internally, it might be able to lower its tax payments by transferring the crude oil into its refinery at the lower posted price and by shifting the profits to its refining subsidiary, where they would be taxed at a lower rate.

Certain non-integrated California refiners might be vulnerable if Texaco should decide to utilize Getty heavy crude oil in this manner. In particular, non-integrated refiners in the San Francisco area served by the Getty trunkline may have no economic alternative source of supply. If these refineries were to fail and Texaco were to acquire them in order to process additional heavy crude oil, the West Cost refining HHI would increase by 74 points to 1206. Additional refining failures in other parts of California might result in a greater increase in concentration.

Relief Required by Paragraph V

Paragraph V and Schedule B would require Texaco to provide certain volumes of Getty heavy crude oil at posted prices to former Getty customers for use in their refineries until mid-1989. Only certain parties are entitled to crude oil under the arrangement. First, the proposed consent excludes major oil company purchasers of Getty heavy crude oil on the premise that they have priority access to other crude oils. Second, the proposed consent excludes California refiners that did not purchase from Getty in 1983. However, such parties would have an opportunity to purchase from Texaco should any existing Getty customer not acquire its full entitlement.

Under the proposed consent order, Texaco would have to sell crude oil at the weighted-average posted price for the purchase of similar grade and quality California crude oil. The price is intended to maintain the competitiveness of non-integrated refiners who are in competition with major refiners purchasing crude oil at the posted price.

The five-year sales arrangement is premised on the opinions of oil industry personnel that additional volumes of offshore crude oil will be available in the late 1980s, remedying any access problems presently being experienced by non-integrated refiners.

Paragraph VI

Paragraph VI of the proposed consent would require Texaco to continue to offer access, for a 10-year period, to Getty customers to a pipeline presently used to transport residual fuel oil within Los Angeles, California. This pipeline is the only transportation mode available to an independent refiner operating in California.

Paragraph VII

Paragraph VII of the proposed consent would require Commission approval for ten (10) years of any acquisition by Texaco of refining or marketing assets in the Northeast, or of petroleum product pipelines in Colorado.

Paragraph VIII

Paragraph VIII of the proposed consent would permit access by Commission representatives to records and documents of Texaco and Getty necessary to assure compliance with this proposed order.

Paragraph IX

Paragraph IX of the proposed order would require Texaco to notify the Commission of any change in corporate structure that may affect its compliance with the proposed order.

Comments Requested

The Commission is interested in receiving public comments on all competition-related issues concerning the Commission's proposed disposition of this matter. Is the antitrust analysis—including the alleged facts and premises underlying that analysis—valid? Are there any competitive problems other then those identified in the proposed complaint and this analysis that should be addressed? Is the proposed relief appropriate? Are any aspects of the relief too narrow or too broad? Are the competitive problems discussed in this analysis serious enough to justify the proposed remedies? To what extent will this decision encourage further acquisitions of middle-tier oil companies, and what would be the likely effects of such acquisitions?

With regard to specific provisions of the proposed consent, is it necessary to divest either the designated Getty Northeast petroleum assets listed in Schedule A(1), or the designated Getty midwest, southwest, and Rocky Mountain petroleum assets listed in schedule A(2), to a single company to assure that a viable competitive entity would result from the divestiture and that there would be no lessening of competition? Is it necessary to require divestitute of the service stations along with the terminals and other wholesale assets to assure that a viable competitive entity would result for the divestiture? Is it necessary to divest Texaco's Northeast Eagle Point refinery and the associated assets listed in Schedule A(3) in a package with the Schedule A(1) properties to assure that a viable competitive entity would result from the divestiture? Is it necessary to require Texaco to divest any of the Schedule A properties to a crude oil producing company? How, if at all, do non-integrated California refiners affect the price and availability of refined products? How workable are the Schedule B provisions requiring continued supply of crude oil to certain non-integrated California refiners? Are there examples of such arrangements in the past and how have they worked? Are the Schedule B provisions too detailed or insufficiently detailed? Is the arbitration provision capable of resolving all disputes between buyers and sellers? What is the validity of the projections that there will be sufficient supplies of heavy crude oil available to independent California refiners, and how justified is the termination of the supply arrangement after five years?

Emily H. Rock,

Secretary.

Dissenting Statement of Commissioner Pertschuk Concerning Texaco/Getty Consent Agreement

February 13, 1984.

I dissent from the Commission's decision to accept the consent agreement with Texaco and Getty because it fails to address adequately the central competitive problem in the acquisition—Texaco's gaining control of Getty's crude oil reserves in California. The Commission acknowledges the competitive risks from the acquisition of these crude reserves—Texaco's cutting off the flow of crude oil to independent refiners in California. But, instead of stopping Texaco from getting the crude, it opts for an uncertain, temporary and highly regulatory approach which will involve us in overseeing the sale of crude to California refiners. And, what's more, this dubious half-measure terminates after five years when Texaco will be free to cut off independents.

---

[21] Texaco document.

[22] 26 U.S.C. 4986–98. The Act imposes a tax on domestic crude oil production (with certain exceptions). The tax is imposed on the holder of the economic interest when the crude oil is removed from the ground.

The fundamental flaw of refusing to stop the acquisition of crude reserves compounds the hands-off antitrust standard of the Reagan administration and effectively invites the major oil companies to race to acquire the reserve-rich middle tier firms. Such a rush to buy would threaten the continued viability of the independent sector of the industry and, thus, the discipline of price competition for the majors.

The Acquisition

This merger is the largest in history. Texaco will pay about $10.1 billion for Getty. The divestiture of assets required by the proposed order amount to about 2% of the total value of the acquisition according to staff so that the overwhelming percentage of this transaction will survive intact. Texaco is now the fourth largest industrial corporation in the U.S. and the third largest oil company with 1982 sales of $47 billion and assets of over $27 billion. Getty is the 14th largest oil company with total 1982 revenues of $12 billion. Getty is the 6th largest oil company in crude reserves, while Texaco is the 8th largest. A combined Texaco-Getty firm will be the third largest crude oil producer and will have almost $60 billion in sales, putting it in a virtual tie with GM and Mobil as the second largest industrial corporation behind Exxon.

The Consent Agreement

The staff has done a thorough and highly commendable job in analyzing this massive acquisition in the short time available under the Hart-Scott-Rodino procedures. (One of the lessons here is that the H-S-R process does not allow adequate time for review by the antitrust agencies, particularly in the case of cash tender offers where a decision to file suit must be made within ten days of the parties' complying with request for information.) In settling this matter, Texaco was willing to sell off assets and make other accommodations in four different areas—wholesale marketing on the east coast, transportation of refined products into Colorado, refining in the northeast, and crude oil and pipelines in California. While it will be extremely useful to hear comments from the public on these provisions, my tentative view is that the staff did an excellent job in analyzing and addressing the concerns in the first three areas. The key deficiency in the settlement is that Texaco is allowed to acquire Getty's assets in California.[1]

Getty's California Crude Oil and Pipelines

The reason Texaco wants to buy Getty is no secret. No one seriously argues that this merger will lead to even theoretical "efficiencies" in scale or production synergies or even ethereal management efficiencies from Texaco learning Getty's secrets. Getty has one overriding attraction—crude oil. It has overall 1.2 billion barrels of proven reserves of crude oil, condensate and natural gas liquids according to a November 1983 report of the American Petroleum Institute. It is the third largest producer of crude oil in California. It, like a number of smaller oil companies rich in crude oil, is an incredibly attractive plum to the major oil companies hungry for dwindling reserves. As stock market values of companies remain low compared to the value of the oil assets they own, and exploration costs go up, the incentive to buy another company's oil rather than develop one's own becomes irresistible. Keeping companies from acting on that powerful incentive when the result would be anticompetitive is one reason we have antitrust laws.

Getty, if this acquisition is consummated, would be the latest in a series of second tier oil firms (*i.e.*, smaller than the big eight) to disappear as independent companies. In the last two years U.S. Steel bough Marathon, Occidental acquired Cities Service, and DuPont bought Conoco. Mobil attempted to buy Conoco and Marathon. Gulf attempted to buy Cities Service. Published reports show that the most likely acquirers for the other second tier companies which are on the selling block are other oil companies. The long term effect of the disappearance of the second tier companies would mean tighter and tighter control of the oil industry by the major companies—from crude production all the way to retail sales of gasoline and home heating oil—and higher prices for consumers.

This particular merger raises problems similar to those we encountered in the Mobil-Marathon acquisition. Like Marathon, Getty has been a source of supply to the independent sector of the industry. The presence of independent refiners and marketers of refined products is a crucial factor in the oil industry, helping to discipline the majors and to maintain lower prices. Consequently, removing a major supplier of independents in a particular section of the country where supplies cannot easily be replaced threatens to damage the viability of the independents and to drive up prices. In Mobil-Marathon, the Commission (with Commissioner Bailey and myself dissenting) refused to challenge the acquisition of Marathon's refining and crude oil assets and was content to see Mobil take over most of Marathon. Fortunately, a private suit stopped that attempted merger. However, the precise scenario of the loss of a reliable supplier of independents—which the Commission's compaint ignored in Mobil-Marathon—is applicable to Texaco's acquisition of Getty's assets in California.

Getty has more crude oil than it can use in California and sells the excess to independent refiners. For example, it supplies Tosco, the largest non-integrated refiner in California. The key competitive problem is that Texaco does not have the same incentives to supply the independent refiners as does Getty. By transferring crude oil to its own refineries rather than sell it on the open market, Texaco can reduce its accounting profits at the crude oil level and, thus, its liability under the Windfall Profits Tax. In addition, by keeping California heavy crude off the market and helping to push up its price to independent refiners, Texaco can cut the profit margins of independent refiners which are its downstream competitors in the refining market and perhaps precipitate a sale of refining assets to itself at bargain prices. Finally, by acquiring Getty's pipelines, Texaco can increase its ability to control the flow of crude oil to refiners, particularly in the San Francisco and Los Angeles areas.

The majority of the Commission acknowledges all these problems by accepting this consent agreement but opts for a risky regulatory solution and one which evaporates after a limited period of time. The proposed agreement provides that Texaco will supply Getty's independent customers, through July 1, 1989, on terms that are set out in the agreement. These terms purport to govern price, volume, transportation, and a host of other terms. The regulatory scheme calls for adopting by reference lengthy, complex contracts now in existence between Getty and its customers. Disputes are to be settled by an arbitrator, and if Texaco and the customer don't agree, they are to resort to the American Arbitration Association. Since Getty's customers are not a party to this agreement, it's not clear to me what rights they have or whether they will be content with this arbitration scheme. The Commission is to preside over all this to make sure there is compliance with all the applicable terms.

Leaving aside the irony that this most deregulatory of administrations, one that wanted to abolish the Department of Energy, has invented a new Crude Allocation Program for the State of California, there are fundamental questions about whether this scheme will work. Traditionally, we have insisted on divestiture or a ban on an acquisition to solve the fundamental type of problems raised here. Requiring the Commission to oversee the relationship between Texaco and its customers, when it is acknowledged that this merger creates fundamental incentives for anticompetitive conduct, is clearly an inferior solution to requiring divestiture or forbidding acquisition of the crude reserves.

Not only is the Commission willing to roll the dice on its regulatory solution, but it terminates after five years in the case of the requirement to supply crude (and 10 years in the case of the requirement to allow access to the Santa Fe Springs—Los Angeles pipeline). The entire justification for the five year limitation in the BC staff memorandum, as far as I can tell, is one sentence: "At that point, many industry observers expect there will be sufficient new offshore supplies of heavy crude oil to satisfy all market demands." This blithely optimistic assertion must be assessed in the context of the staff's arguments that California heavy crude is a separate market and that existing refiners have invested heavily in particular facilities in reliance upon its continued supply. In addition, heavy crude oils are not imported and access to supply will continue to be limited by whoever controls the pipelines.

The staff states that the most likely anticompetitive effect of Texaco's acquisition of Getty's California crude and pipelines "may be denial of crude oil and transportation to the independent sector of the California refining industry, leading to refining failures and perhaps a significant increase in West Coast refining concentration." These economic stakes are too enormous to justify the risks that the Commission is willing to run with this consent agreement. Section 7 of the Clayton Act prohibits acquiring a company when the effect anywhere in the country "*may* be substantially to lessen competition." (Emphasis added.) I do not believe that Congress intended that the antitrust agencies should accept inadequate remedies. That we would do so in the case of the largest merger in history and with the attendant risks of inviting a run of such acquisitions surely falls short of our mandate.

---

[1] My views on this consent agreement relate to the prosecutorial decision of whether to challenge this merger or accept this settlement. If we were to reject the settlement and issue a complaint, my judgment on the merits would be based on the adjudicatory record.

The Consent Agreement Procedure

The consent agreement allows Texaco to acquire Getty's stock immediately. However, it requires the Getty stock to be held separate during the comment period. The extent to which Getty will operate as an independent entity is somewhat unclear since Texaco may elect a new Board of Directors of Getty, of which half may be Texaco employees and outside Texaco directors. In any event, the Commission is now foreclosed from attempting to enjoin the acquiring of Getty stock even if it rejected the consent agreement, though it could in theory reject the proposed cosent at the end of the comment period and seek a court order to maintain the hold separate provisions in effect.

The public comment process should shed as much light as possible on the proposed agreement. I would encourage commenters to focus on, among other things, the following questions:

1. To what extent will this decision encourage further acquisitions of middle tier oil companies, and what are the likely effects of these acquisitions?

2. How workable are the provisions requiring continued supply of crude oil to independent refiners? Are there examples of such arrangements in the past and how have they worked?

3. What is the validity of the projection that there will be sufficient supplies of heavy crude oil available to California refiners and how justified is the termination of the supply arrangement after five years?

Conclusion

I do not question the good faith of my fellow Commissioners in holding their final judgment on this consent agreement in abeyance until the end of the comment period. But realism suggests that the comments are not likely to alter the outcome and that oil mergers will increase in frequency in the coming months. This being the case, I believe it would be wise for Congress to look again with close scrutiny at the oil industry—an industry whose history has long been shadowed by heroic efforts to suppress the threat of vigorous competition—with an eye toward imposing clearly defined restraints on oil company mergers.

[FR Doc. 84-6041 Filed 3-6-84; 8:45 am]

BILLING CODE 6750-01-M

TEXACO

1050 Seventeenth Street, N.W., Suite 500
Washington, D.C. 20036
(202) 331-1427

NEWS FROM TEXACO

Attachment D

TEXACO AGREES TO TRANSFER GETTY MARKETING ACTIVITIES IN NORTHEAST AND MIDDLE ATLANTIC UNITED STATES TO POWER TEST CORPORATION

FOR IMMEDIATE RELEASE: SUNDAY, JANUARY 29, 1984.

WHITE PLAINS, N.Y., Jan. 29. - Texaco Inc. announced today that it has entered into an agreement under which it would transfer substantially all of Getty Oil Company's marketing activities in the Northeastern and Middle Atlantic regions of the United States to Power Test Corp., which is headquartered in Plainview, N.Y.

Included in the agreement is the sale of approximately 600 Getty investment class service stations in the region. Power Test has agreed to assume contractual obligations to supply approximately 1,300 additional Getty stations.

Under the terms of the agreement, the sale would take place after Texaco acquires control of Getty Oil Company. The sale also is contingent upon Hart-Scott-Rodino procedures with the appropriate antitrust review agencies.

The agreement calls for a sale price of $90-million, subject to adjustment following appraisal of the real estate and inventories involved.

Texaco also has agreed to assist in supplying the petroleum product requirements of Power Test for the acquired properties by selling up to 22 million barrels a year of gasoline and 11 million barrels a year of middle distillate petroleum products for a period of three years following the sale.

The investment class stations being sold are located in 11 states -- New York, New Jersey, Pennsylvania, Maryland, Delaware, Massachusetts, Connecticut, Rhode Island, Maine, New Hampshire and Vermont. Nine marketing terminals are included in the transaction.

Power Test Corp. is the largest independent petroleum marketing company on the East Coast, with approximately 450 service stations in New York, New Jersey Pennsylvania, Massachusetts, and Connecticut.

-xxx-

TEXACO

1050 Seventeenth Street, N.W., Suite 500
Washington, D.C. 20036
(202) 331-1427

NEWS FROM TEXACO

Attachment E

FOR IMMEDIATE RELEASE: FRIDAY, JANUARY 27, 1984.

WHITE PLAINS, N.Y., Jan. 27 - In response to press inquiries, Texaco Inc. today stated that its intentions are to continue supplying gasoline and other petroleum products at competitive prices to Getty Oil Company customers, both branded and unbranded, following the Texaco-Getty merger. This policy is applicable to refined products produced at Getty's three refineries in the United States. Should Texaco ever dispose of any of these refineries, we would use our best efforts to ensure that any subsequent operator continue these marketing practices.

###

Attachment F

REPORT ON
DIRECT SHAREOWNERSHIP
IN
SIXTEEN U.S. OIL COMPANIES

A STUDY OF THEIR DEMOGRAPHIC CHARACTERISTICS

VOLUME I

Conducted
for
The American Petroleum Institute
by
The New York Stock Exchange, Inc.

June, 1981

CONTENTS

VOLUME I

Page

-- Introduction
-- Participating Oil Companies 2
-- Highlights 3

DIRECT SHAREOWNERSHIP

-- Estimate of Direct Shareowners of Sixteen Participating Oil Companies 4
-- Estimate of Direct Shareowners in Named Accounts 5
-- Estimate of Direct Shareowners in Street Name Accounts 5
-- Estimate of Direct Shareowners through Employee Savings Plans 6
-- Stockholders-of-Record on Books of 16 Participating Oil Companies 6

CHARACTERISTICS OF NAMED SHAREOWNERS

-- Demographic Profile 7
-- Sex 7-8
-- Age 9-10
-- Household Income - 1979 11-12
-- Education 13
-- Occupation 14-15
-- Marital Status 15
-- Household Position 16
-- Other Household Shareowners 16
-- Investment Ownership 17
-- Proportion of Assets Invested in Stock 18
-- Market Value of Stock Investment 19
-- Proportion Invested in Oil Company Stock 20
-- Means of Acquiring Oil Company Stock 21
-- Sole vs. Joint Ownership 22
-- Regional Distribution 23
-- State Distribution 24-25

SUPPLEMENTAL CHARACTERISTICS OF DIRECT OWNERS

-- When Shareowners First Acquired Stock 26
-- How Shareowners First Acquired Stock 27
-- Various Means Shareowners Used to Obtain Stock 28
-- Stock Market Activity Since January 1975 29
-- Stock Market Activity Since Most Recent Reduction in Capital Gains Tax 30
-- Use of Sales Proceeds by Net Sellers 31
-- Participation in Dividend Reinvestment Plans 32
-- Number of Dividend Reinvestment Plans Joined 33
-- Proportion of Dividends Reinvested, Saved and/or Spent 34-35
-- Proportion of Shareowners Investing in Various Financial Vehicles 36

Page

COMPARISON TO 1974 STUDY

-- Estimate of Direct Shareowners in Six Largest Oil Companies 37
-- Estimate of Direct Shareowners in Named Accounts 38
-- Estimate of Direct Shareowners in Street Name Accounts 38
-- Estimate of Direct Shareowners through Employee Savings Plans 39
-- Demographic Profile 39-40
-- Participating Oil Companies 40

METHODOLOGY

-- Collection of Data 41
-- Intra-Company Unduplication 42
-- Sample Design and Selection 42
-- Telephone Survey Procedure 42
-- Mail Surveys 42
-- Inter-Company Unduplication 43
-- Direct Shareowners in Street Name Accounts 48
-- Direct Shareowners in Employee Savings Plans 48
-- Tables 49-57
-- Reliability of Survey Percentages 58
-- Sampling Tolerances when Comparing Two Subsamples 59
-- Exhibits

INTRODUCTION

The New York Stock Exchange has undertaken this study on behalf of the American Petroleum Institute to:

1) Estimate the unduplicated number of direct and indirect shareowners in sixteen API member oil companies.

2) Determine the demographic and financial characteristics of direct shareowners.

3) Develop demographic profiles of indirect shareowner groups.

4) Develop comparative data where possible for the six largest oil companies participating in a similar study conducted in 1974.

Scope of Report

This report consists of two volumes. Volume I contains material regarding direct shareownership, while Volume II deals with indirect ownership, and contains detailed cross-tabulations. Comparative data on direct shareownership in the six largest oil companies participating in a similar study done in 1974 are also included in Volume I. Because of the difficulties encountered in obtaining indirect shareownership data for the sixteen oil companies, efforts to obtain comparable data for the six largest oil companies were abandoned. Details regarding these efforts appear in the Introduction of Volume II.

Characteristics for individual shareowners of the sixteen oil companies can be found in Volume I. These data were obtained through a combination of telephone and mail surveys. The bulk of the data, derived from the telephone survey, were weighted using the procedures described in the Methodology.

To insure representativeness, two additional mail surveys were conducted among shareowners sampled but not reached in the telephone survey. All three mail questionnaires included both new material and old for cross-validation purposes. Samples of these questionnaires can be found in the Methodology as Exhibits C and D. Since the mail survey results are considered representative, their answers constitute a useful source of additional information regarding oil company shareowners. These results, unweighted, can be found in Volume I.

Where appropriate, comparisons are drawn between the 1980 or 1974 oil company surveys and the Exchange's 1980 national shareownership survey or its 1977 Public Attitude Survey. For clarity of presentation, all tables in Volume I reflect only the totals from the cross-tabulations. Analyses accompanying the tables, however, are often based on the full details within one or more such cross-tabulations

SIXTEEN OIL COMPANIES PARTICIPATING IN THE STUDY

Ashland Oil, Inc.
Atlantic Richfield Company
Cities Service Co.
Conoco Inc.
Exxon Corporation
Gulf Oil Corp.
Mobil Corporation
Occidental Petroleum Corporation
Phillips Petroleum Co.
Standard Oil Co. of California
Standard Oil Co. (Indiana)
Standard Oil Co. (Ohio)
Sun Company, Inc.
Tenneco Inc.
Texaco Inc.
Union Oil Co. of California

HIGHLIGHTS

- Direct and indirect shareowners of the sixteen participating oil companies total more than 85.4 million; slightly over three million direct and 82.4 million indirect.
- A majority of the more than 3,000,000 direct shareowners are non-employed women, with a median age of 63; most women are married, but 3-in-10 are widowed.
- The majority of direct male shareowners are employed, with 8-in-10 married and fewer than 1-in-10 widowed; however, their median age is also 63.
- Overall, the median age for all direct oil company shareowners has advanced 4½ years since the 1974 study; nationally the median age of shareowners retreated seven years between 1975 and 1980.
- Median 1979 household income for direct oil company shareowners was $28,100, close to that for all U.S. shareowners.
- Dividends are important in the income picture of oil company shareowners: 44% of those 65 years of age or older have annual household incomes under $25,000; 13% report incomes under $10,000.
- One-third of oil company shareowners reside in the Northeast. Nearly one-in-four are concentrated in the Middle Atlantic region. California remains the leading oil company shareowner state; no major geographic shifts are discernible since 1974.
- Direct individual shareowners in this study's sixteen oil companies have considerably more education than shareowners nationally.
- The median value of oil company shareowner portfolios has risen since 1974, while that for all shareowners dropped.
- Direct shareownership among the six largest oil companies showed little, if any, growth between the 1974 and 1980 studies.
- Nearly half of oil company shareowners bought more stock than they sold during the 1975-1981 period; and the last reduction in capital gains taxes was a positive influence.
- One-third of oil company shareowners participate in the dividend reinvestment plans of the companies whose stock they own.

DIRECT SHAREOWNERSHIP

Table 1

ESTIMATE OF DIRECT SHAREOWNERS OF SIXTEEN PARTICIPATING OIL COMPANIES

	Shareowners	Percent
Shareowners in named shareowner accounts	2,330,000	77%
Shareowners in street name accounts	370,000	12
Shareowners through oil company savings plans	340,000	11
Total direct shareowners	3,040,000	100%

Analysis

Direct shareowners in the sixteen oil companies participating in this study are estimated to total 3,040,000. The total does not include any estimate for direct owners through nominee accounts because of the paucity of information available about this segment of shareowners.

Data for 1980 were also developed on direct shareownership in the six oil companies which participated in the 1974 study. Between 1975 and 1980, total individual domestic stockholders-of-record in these six largest oil companies increased only 26,000 or less than 1,000 per company per year. Indirect shareownership, at least for the six largest oil companies, may have increased. The Exchange's latest study of indirect shareownership on a nationwide basis shows an overall increase of 11%, from 120 million to 133 million, over the 1975-1980 period.

Although the overall level of direct shareownership appears down for the period 1974-1980, direct shareownership in the six largest oil companies via various types of employee stock purchase plans in which the employee has an actual ownership interest is up slightly. Shareownership through street name holdings appears down, but the trend data are not strong enough to support further analysis. Ordinarily, the stock of larger oil companies is not of great interest to margin customers. However, greater numbers of shareowners in street name accounts could have been attracted by the strong performance of the oil industry in the past two or three years to the benefit of some of the smaller companies in the oil industry -- particularly those traded on the American Stock Exchange and over-the-counter markets.

Table 1a

ESTIMATE OF DIRECT SHAREOWNERS IN NAMED ACCOUNTS

Total stockholders-of-record	3,423,000
Less foreign and non-individual stockholders	- 179,000
Total individual domestic S.O.R.	3,244,000
Additional shareowners in multiple-owned accounts (less intra-company duplication)	+ 585,000
	3,829,000
Less estimated inter-company duplication	-1,499,000
Total shareowners in named accounts	2,330,000

Table 1b

ESTIMATE OF DIRECT SHAREOWNERS IN STREET NAME ACCOUNTS

Estimated shareowners in street name accounts unduplicated on inter and intra-company basis	421,000
Less estimated shareowners holding in both own and street name	-51,000
Net number of direct shareowners cwning through street name stock	370,000

Table 1c

ESTIMATE OF DIRECT SHAREOWNERS THROUGH EMPLOYEE SAVINGS PLANS

Shareowners enrolled in employee plans	378,000
Less employees owning through named shareowner accounts	-38,000
Employee plan shareowners	340,000

Table 1d

STOCKHOLDERS-OF-RECORD ON BOOKS OF 16 PARTICIPATING OIL COMPANIES

Individuals (males & females combined)		2,344,731
Males	1,059,205	
Females	1,285,526	
Joint accounts		638,008
Fiduciary individuals		259,879
All other		150,802
Fiduciary institutions	42,944	
Stock brokers & security dealers	2,895	
Nominees	35,345	
Institutions & miscellaneous	69,618	
Total domestic stockholders		3,393,420
Foreign stockholders		29,162
Total stockholders-of-record		3,422,582

CHARACTERISTICS OF NAMED SHAREOWNERS

Table 2

DEMOGRAPHIC PROFILE OF TYPICAL DIRECT OIL COMPANY SHAREOWNERS

Sex	Female (54%)
Median age	63.4 yrs.
Median household income	$28,100
Median years of education	16 yrs.
Occupation	Not employed: Retiree/housewife
Marital status	Married
Median portfolio value	$41,700
Oil stock as % total stock	26% (median)
Likely residence	Middle Atlantic state

Caveat

The demographic findings of this study are fully representative of the sixteen participating oil companies. They reveal a shareowner base consisting mostly of investors far older and with larger portfolios than the national norms. However, these oil company shareowners are probably not typical of stockholders in the dozens of other, smaller oil companies although, no doubt, they outnumber the others substantially. The NYSE, alone, lists 57 other "petroleum, natural gas" companies not included in this study; and the American Stock Exchange and over-the-counter market could add hundreds to these. Very likely, if substantial numbers of shareowners from these other oil companies were surveyed and the results combined with those from this study, the resulting demographic profile would resemble the national shareowner picture more closely.

Table 3

ESTIMATE OF DIRECT SHAREOWNERS BY SEX

	1980 Direct Shareowners	
	Sixteen Oil Companies	U.S. Adult Shareowners
Male	46%	51%
Female	54	49
	100%	100%

Analysis

Females outnumber males among the 2,199,000 oil company shareowners for whom demographics are available, while nationally the statistics favor males.

The median age of women oil company shareowners is a little over 63 years. Their national counterpart is considerably younger, 48 years. Although more women than men oil company shareowners are aged 75 years or older, men aged 65-74 years outnumber women. Overall, the median ages for both are identical.

Nearly three-fourths of all women oil company shareowners are not employed, compared to 42% of women shareowners nationally. Half of the female oil company shareowners are housewives and half are retired. Among the 26% of women employed, about half are professional or technical workers compared to only one-third nationally. Another large segment are employed as clerks or sales people or as managers, officials or proprietors -- 29% and 16% respectively. Nationally these statistics are 33% and 22% for all women shareowners.

The majority of women are married, but nearly 3-in-10 are widowed. Despite these statistics nearly three-of-four say they own their oil company shares alone; only 28% say they own jointly or both ways. Nationally, better than two-thirds of women shareowners are married.

Although nearly half the women report inheriting some oil company stock, 75% said they bought shares themselves. They are more likely than men to receive oil company shares as a gift or bonus but less likely to have accumulated them under an employee stock purchase or option plan.

Women oil company shareowners are less likely than men to have life insurance, but they are just as likely to own investment real estate, non-oil company common stock and other investments.

Although fewer in number, male oil company owners report higher median household incomes than their female counterparts. To a large extent, this is the result of better education. The proportions of men and women completing college are about equal, but males are more likely to have taken graduate study than females. Women are more likely to have only completed high school or had some college before marrying or entering the work force.

The majority of male oil company shareowners are employed; nearly all of those not employed are retired. Most men (23%) are employed in professional or technical fields; the remaining are managers, officials or proprietors (13%) or in clerical, sales or other white collar jobs (9%). About 8-in-10 males are married and fewer than 1-in-10 are widowed. Because of this, men tend to own their stock jointly rather than alone. More so than women, they bought oil company shares themselves or accumulated them under an employee stock purchase or option plan rather than inheriting or receiving them as gifts.

The market value of men's investment in common and preferred stock appears greater than that of women. Better than one-in-four say their investment is $100,000 or over compared to about one-in-seven women. However, many women -- almost a fourth -- said they didn't know the amount of these investments currently. More than likely, these are older women with substantial portfolios under professional management. If so, the distribution of market value invested in common and preferred stock for men and women could actually be quite similar.

On average, common and preferred stocks represent nearly half of the market value of all the current investments of men and women oil company shareowners. However, this figure does not include their homes or personal possessions. Many women (29%) also responded "don't know" to this question. Had they answered, women's averages might exceed those of men. Oil company stock alone averages about 39% of the value of all common and preferred stock in males' portfolios and 35% of females'. Nearly one-in-five females said "don't know" to this question.

Overall, men's investments in oil stock constitute about 19% of the value of all their investments, excluding house and personal possessions. For women, this figure is slightly lower, about 17%.

Table 4

AGE OF SHAREOWNERS

	1980 Direct Shareowners	
	Sixteen Oil Companies	U.S. Adult Shareowners
21 - 24 years	*%	5%
25 - 34 years	5	19
35 - 44 years	9	21
45 - 54 years	16	20
55 - 64 years	23	18
65 - 74 years	28	13
75 or more years	19	3
No answer	1	1
	100%	100%
Median age	63.4 years	47.6 years

---

* Less than 0.5%.

Analysis

With better than 4-in-10 retired, the median age of oil company shareowners, not surprisingly, is near the 65 level. Nearly 19% are 75 years of age or older; another 27% are aged 65-74. Overall, an estimated one million oil company shareowners, or 46%, are 65 years or older. By contrast, according to the Exchange's national shareownership study, the number of senior citizen-shareowners 65 years or older was 16% in 1980.

The statistics of advanced age and retirement among so many oil company shareowners have corollary effects as well:

-- 60% of all oil company shareowners have no other adult or minor shareowners in the household

-- 20% are widowed

-- 52% are female head of household

-- only 61% have life insurance

Among oil company shareowners 65 years of age or older, 44% have annual household incomes under $25,000; 13% report incomes under $10,000. These data dramatize the importance of dividends, especially for senior citizens.

A combination of factors indicate a continued high level of the elderly among oil company shareowners. Older investors are very partial to low-risk stocks, especially those paying high dividends. This stems from their low threshold of risk willingness and their need for funds to supplement modest retirement incomes eroded by inflation. Apparently, the oil companies in this study satisfy the elderly on these scores. In addition, U.S. population is aging, thus assuring a growing supply of potential investors to whom oil stocks are likely to appeal. In 1980, the median age of the U.S. population reached 30 years according to the Census Bureau. This is an increase of more than two years between 1979 and 1980. The rise was primarily a result of a 24% jump in persons 65 years or older and a 14% decline in the number of children under 14 years of age. Demographers forecast continued growth in the ranks of senior citizens as more and more children of the 1946-1964 baby boom mature, reach peak earnings levels and retire.

Table 5

HOUSEHOLD INCOME OF SHAREOWNERS

	1980 Direct Shareowners	
	Sixteen Oil Companies	U.S. Adult Shareowners
Under $10,000	8%	6%
$10,000 - $14,999	8	11
$15,000 - $19,999	9	8
$20,000 - $24,999	10	17
$25,000 - $34,999	16	24
$35,000 - $49,999	16	17
$50,000 - $99,999	10	9
$100,000 and over	4	5
No answer	19	2
	100%	100%
Median 1979 household income	$28,100	$27,750

Analysis

Oil company shareowners have household incomes about equal to the general shareowner population: on a median basis, their household income is $28,100. Had the large proportion which refused to provide household income information (23%) actually done so, the likelihood is that the proportions in the higher income classes would have been even greater. In turn, the median household income would also have been higher.

Past shareowner studies have shown that income declines with advanced age, and this holds for oil company shareowners as well. Those 65 years and over report median incomes about $10,000 below those under 45 years of age. However, the somewhat larger proportions of older people refusing to give their incomes probably depressed the median for the elderly.

As could be expected, oil company shareowners with more education report higher household income. Concomitantly, greater proportions of those in the upper-income brackets are employed in professional or technical occupations or as managers, officials or proprietors.

While nearly 9-in-10 oil company shareowners report passbook savings, ownership or investment in other financial vehicles is more strongly related to higher income. This is particularly true of money market funds and investment real estate; to a lesser extent this holds for insurance, corporate bonds, preferred stock, stock mutual funds and common stock other than that of oil companies.

Common and preferred stock represent about half the value of investments among oil company shareowners with the lowest and highest incomes. Among those in the $25,000 to $35,000 bracket, the average is closer to 40%. Actual market value of common and preferred stock currently invested rises steadily with household income. Greater proportions of upscale oil company shareowners are likely to be married and lesser proportions single or widowed.

The lower the income, the greater the likelihood the oil company shareowner is widowed, owns his oil stock alone and has no other adult or minor shareowners in the household. Not surprisingly, the value of oil company stocks represents a greater proportion of the stock portfolio among lower-income households. As noted previously, oil company shareowners with lower incomes are likely to include many older, retired people.

Table 6

EDUCATION OF SHAREOWNERS

	1980 Direct Shareowners	
	Sixteen Oil Companies	U.S. Adult Shareowners
Some elementary	*%	1%
Completed elementary school	3	1
Some high school	5	4
Completed high school	17	20
Some college	16	25
Business or technical school	6	9
Completed college	32	19
Graduate study	21	19
No answer	1	2
	100%	100%
Median years	16 yrs.	15 yrs.

---

* Less than 0.5%

Analysis

Direct individual shareowners in this study's sixteen oil companies have considerably more education than shareowners nationally. The major difference is in the proportion completing college, as opposed to completing high school or having only some college. On a median basis, oil company shareowners reported 16 years of education.

Table 7

OCCUPATIONS OF SHAREOWNERS

	1980 Direct Shareowners	
	Sixteen Oil Companies	U.S. Adult Shareowners
Employed		
Professional or technical	17%	23%
Managers, officials, proprietors	8	20
Clerical, sales, other white collar	8	15
Craftsmen, foremen	*	6
Operatives, laborers	2	5
Farmers, farm laborers	1	1
Service workers	1	1
Armed forces	*	*
Not Employed		
Retired	43	14
Students	*	*
Housewives	20	13
Other	*	2
	100%	100%

---

* Less than 1%

Analysis

Better than 4-in-10 oil company shareowners are retired. Another 2-in-10 are housewives. This is considerably higher than the 14%

retired and 13% housewives on the national level. Together these totals so distort the employment data that professionals, managers and clericals nationally appear considerably higher. Actually, on a proportional basis, oil company statistics are quite impressive. Professionals outnumber managers better than two-to-one; and the relationship between the clerical and managerial groups is one-to-one. The superiority of the oil company shareowner mix is borne out by their higher incomes.

Table 8

MARITAL STATUS OF SHAREOWNERS

	1980 Direct Shareowners	
	Sixteen Oil Companies	U.S. Adult Shareowners
Married	68%	76%
Single	9	11
Separated	*	2
Widowed	20	6
Divorced	3	5
No answer	*	1
	100%	100%

---

* Less than 1%

Analysis

Among oil company shareowners, the proportion of widowed people is high -- more than three times that for all U.S. shareowners. Naturally, this has the effect of reducing the relative importance of other groups. Except for the large concentration of the widowed and the lower incidence of divorce, the distribution is quite similar to that for national shareownership.

As noted in the discussion on age, the incidence of the elderly among oil company shareowners is likely to remain high. Barring major shifts in life expectancy, widows will continue to outnumber widowers.

Table 9

POSITION OF SHAREOWNERS IN HOUSEHOLD

Male head of household	46%
Female head of household	54%
	100%

Analysis

The proportions of male to female heads of household were identical to the distribution of men and women shareowners.

Table 10

OTHER HOUSEHOLD INDIVIDUALS WHO ARE OIL COMPANY SHAREOWNERS IN ADDITION TO RESPONDENTS

	Sixteen Oil Companies
Some other household member owns stock	40%
No other household member owns stock	60
	100%

Analysis

Six out of every ten oil company shareowners live in households without other shareowners. Based on the other evidence available from this study, the likelihood is most live alone altogether. This has important implications for oil company communications efforts with these shareowners.

Because of the large numbers of oil company shareowners of advanced age, ownership of life insurance is well below that of the typical investor. Additional data detailing ownership of other financial products are in Table 29.

Table 11

OWNERSHIP OF OTHER INVESTMENTS BY SHAREOWNERS

	Sixteen Oil Companies	12.1 Million U.S. Households - 1978*
Life insurance	61%	95%
Investment real estate (other than home)	28	39
Passbook savings account	86	93
Corporate bonds	29	13
Common stock other than oil company stock	86	NA
Preferred stock other than oil company stock	34	25 1/
Stock mutual funds	29	26
Money market funds	47	6
Don't know/refused	1	0

---

* Household data from Public Attitudes toward Investing, New York Stock Exchange, 1977 (respondents with income of $10,000 and over).

1/ 12.1 million households owning preferred stock in addition to listed common stock.

Analysis

In many respects, oil company shareowners show a pattern of ownership for investments other than stock that is characteristic of older, affluent investors. This is evidenced by high levels of ownership in financial products such as corporate bonds and preferred stock in addition to common stock ownership. Moreover, 86% report ownership of common shares other than oil company stock. Smaller proportions have investment real estate, passbook savings and stock mutual funds.

Nearly half of all direct oil company shareowners now invest in money market funds, a relatively new financial vehicle to investors in 1978. This accounts for the disparity of investment in these funds between oil company investors and shareowners nationally.

Table 12

VALUE OF STOCK PORTFOLIO AS PERCENT OF TOTAL INVESTMENTS

Less than 10%	5%
10% - 24%	12
25% - 49%	17
50% - 74%	21
75% - 99%	18
100%	2
Don't know	20
No answer	5
	100%
Stock as % of total investment (Median %):	55%

Analysis

Outside of home and personal possessions, stock represents better than half the value of the typical (median) oil company shareowner's total investments. In the case of one out of every five shareowners, stock accounts for 75% or more of their investments. The proportion of total investments committed to stock rises with both income and age, but is the same for men and women.

Table 13

MARKET VALUE RANGES OF SHAREOWNERS' STOCK PORTFOLIOS

	1980 Direct Shareowners	
	Sixteen Oil Companies	U.S. Adult Shareowners
Less than $10,000	15%	64%
$10,000 - $24,999	15	15
$25,000 - $49,999	15	8
$50,000 - $99,999	15	4
$100,000 or more	20	4
Don't know/no answer	20	5
	100%	100%
Median market value	$41,700	$4,000

Analysis

The estimated value oil company shareowners attribute to their stock portfolio is ten times that of all U.S. shareowners. On a median basis, oil company shareowners report the market value currently invested in common and preferred stock to be $41,700, while nationally the figure is $4,000. The proportion with portfolios valued between $50,000 and $100,000 is nearly four times the national level and the proportion with portfolios of $100,000 and up is five times as great as found nationally.

Table 14

MARKET VALUE OF OIL COMPANY STOCK AS PERCENT OF TOTAL STOCK

Less than 10%	14%
10% - 24%	27
25% - 49%	15
50% - 99%	15
100%	13
Don't know	14
No answer	2
	100%
Median is	26%

Analysis

Oil company stock typically accounts for about 26% of all the stock in the portfolios of oil company shareowners. As could be expected, shareowners with higher incomes report their oil company shares represent a smaller proportion of their total portfolios. This is also true of older investors and females as well.

Table 15

HOW DIRECT SHAREOWNERS ACQUIRED OIL STOCK NOW OWNED

Purchased by respondent	80%
Inherited	38
Received as a gift or bonus	13
Accumulated under an employee stock purchase or option plan	15

Analysis

Most shareowners acquired their oil stock themselves by purchase. This is true regardless of income, age or sex. However, if the shareowner is older or a male, the likelihood of acquisition by purchase is greater.

Close to 4-in-10 shareowners have inherited some oil company stock. Nearly half of all women oil company shareowners own some stock acquired this way. This incidence of ownership by inheritance is also reported more frequently among those with higher household incomes, younger (under 45) investors and those aged 55-64 years.

Almost one-third of all shareowners under 45 years of age own some oil stock they received as a gift or bonus, a much higher incidence than among other oil shareowner age groups.

Overall, slightly more than 15% of oil company shareowners have accumulated some current shares through an employee stock purchase or option plan. Acquiring stock this way is more prevalent among men than women and among shareowners in the middle-income ranges.

Table 16

SOLE VS. JOINT STOCK OWNERSHIP

Stock owned solely by direct shareowner	70%
Stock owned jointly by direct shareowner and other person(s)	24
Stock owned both solely and jointly	6
	100%

Analysis

Nearly three-quarters of oil company shareowners are sole owners of their stock, not surprising considering the large numbers of widows and widowers among them.

Table 17

GEOGRAPHIC DISTRIBUTION OF DIRECT SHAREOWNERS BY REGION
SIXTEEN OIL COMPANIES VS. 1980 U.S. POPULATION

Region	1980 Shareowners 16 Oil Companies	1980 U.S. Population	1980 16 Companies over or under U.S. Population
Northeast	33.0%	21.8%	11.2 percentage pts.
New England	8.5	5.5	+ 3.0
Middle Atlantic	24.5	16.3	+ 8.2
North Central	23.0	26.0	3.0
East North Central	16.6	18.4	- 1.8
West North Central	6.4	7.6	- 1.2
South	28.4	33.2	4.8
East South Central	3.7	6.5	- 2.8
South Atlantic	14.3	16.2	- 1.9
West South Central	10.4	10.5	- 0.1
West	15.6	19.0	3.4
Mountain	3.8	5.0	- 1.2
Pacific	11.8	14.0	- 2.2
	100.0%	100.0%	

Analysis

One-third of oil company shareowners reside in the Northeast, with nearly one-quarter concentrated in the Middle Atlantic states alone. This region has an above-average representation of younger oil shareowners (under 45 and 45-54 years of age) and a below-average proportion of oil shareowners aged 75 years and over. Greater percentages of shareowners with incomes under $15,000 and $15-25,000 also live here.

The South, North Central and West account for the next highest percentages of shareowners in descending order. The South has the largest proportion of shareowners with incomes of $50 thousand or more. The North Central region contains the single largest concentration of oil company shareowners aged 75 or over.

Table 18

GEOGRAPHIC DISTRIBUTION OF DIRECT SHAREOWNERS BY STATES SIXTEEN OIL COMPANIES VS. 1980 U.S. POPULATION

State	1980 Shareowners 16 Oil Companies	1980 U.S. Population	1980 16 Companies over or under U.S. Population
Alabama	.6%	1.7%	- 1.1 percentage pt
Alaska	.1	.2	- .1
Arizona	1.2	1.2	0
Arkansas	.4	1.0	- .6
California	11.6	10.5	+ 1.1
Colorado	1.3	1.3	0
Connecticut	2.6	1.2	+ 1.4
Delaware	.4	.3	+ .1
District of Columbia	.7	.3	+ .4
Florida	5.6	4.2	+ 1.4
Georgia	1.1	2.4	- 1.3
Hawaii	.3	.4	- .1
Idaho	.3	.4	- .1
Illinois	5.7	5.0	+ .7
Indiana	1.6	2.4	- .8
Iowa	.8	1.3	- .5
Kansas	.9	1.0	- .1
Kentucky	1.3	1.6	- .3
Louisiana	1.7	1.9	- .2
Maine	.6	.5	+ .1
Maryland	1.7	1.9	- .2
Massachusetts	3.8	2.5	+ 1.3
Michigan	2.7	4.1	- 1.4
Minnesota	1.1	1.8	- .7
Mississippi	.5	1.1	- .6
Missouri	2.2	2.2	0
Montana	.4	.3	+ .1
Nebraska	.3	.7	- .4
Nevada	.2	.4	- .2
New Hampshire	.6	.4	+ .2
New Jersey	5.6	3.3	+ 2.3
New Mexico	.3	.6	- .3
New York	11.3	7.9	+ 3.4
North Carolina	1.3	2.6	- 1.3
North Dakota	.1	.3	- .2
Ohio	4.3	4.8	- .5
Oklahoma	1.5	1.3	+ .2
Oregon	.9	1.2	- .3
Pennsylvania	6.4	5.2	+ 1.2
Rhode Island	.4	.4	0
South Carolina	.6	1.4	- .8
South Dakota	.1	.3	- .2
Tennessee	1.0	2.0	- 1.0
Texas	7.6	6.3	+ 1.3

Table 18 (Continued)

State	1980 Shareowners 16 Oil Companies	1980 U.S. Population	1980 16 Companies over or under U.S. Population
Utah	.2%	.6%	- .4 percentage pts.
Vermont	.3	.2	+ .1
Virginia	2.2	2.4	- .2
Washington	1.0	1.8	- .8
West Virginia	.6	.9	- .3
Wisconsin	1.9	2.1	- .2
Wyoming	.1	.2	- .1
	100.0%	100.0%	

Analysis

California is the leading oil company shareowner state, although the West has the fewest oil shareowners of the four regions. Nearly as large in shareownership, 11.3%, is New York. Other large shareowner contributors are Texas, Pennsylvania, Illinois, New Jersey and Florida.

SUPPLEMENTAL CHARACTERISTICS OF DIRECT SHAREOWNERS

The following data were obtained from three mail surveys taken during the course of validating telephone survey results or collecting inter-company unduplicating statistics. Though unweighted, they are a good representation of selected direct oil company characteristics which comprise a valuable addition to those from the telephone phase. For details on sample representativeness, please see the Methodology.

Table 19

WHEN SHAREOWNERS FIRST ACQUIRED STOCK OR MUTUAL FUND SHARES

	1980 Direct Shareowners	
	Sixteen Oil Companies*	Total U.S.
Before 1970	85%	60%
1970 - 1974	6	13
1975 - 1980	5	24
No answer	4	3
	100%	100%

---

* Unweighted

Analysis

More so than shareowners nationally, oil company investors have been owners for ten or more years. Notably, oil company shareowners becoming first-time investors between 1975 and 1980 are outnumbered nationally nearly five-to-one.

Table 20

HOW SHAREOWNERS FIRST ACQUIRED STOCK OR MUTUAL FUND SHARES

	1980 Direct Shareowners	
	Sixteen Oil Companies*	Total U.S.
Through a bank	2%	4%
Through a stockbroker or dealer	37	40
Through an employee stock purchase plan	7	28
Through an insurance agent	-	3
As a bonus from the company you worked for	3	3
As a gift or inheritance	21	16
Some other way	-	1
No answer	30	5
	100%	100%

---

* Unweighted

Analysis

Most oil company shareowners first acquired some kind of stock or mutual fund through a stockbroker or dealer. Better than one-in-five did so through a gift or inheritance. The proportion becoming first-time shareowners by way of an employee stock purchase plan is only one-fourth the national figure.

Table 21

VARIOUS MEANS SHAREOWNERS HAVE USED TO OBTAIN STOCK OR MUTUAL FUND SHARES

	1980 Direct Shareowners	
	Sixteen Oil Companies*	Total U.S.
Through a bank	8%	10%
Through a stockbroker or dealer	55	58
Through an employee stock purchase plan	19	44
Through an insurance agent	1	7
As a bonus from the company you worked for	4	13
As a gift or inheritance	38	28
Through a stock split or stock dividend	51	37
Some other way	2	5
No answer	18	2

---

* Unweighted

Analysis

Considering the various means oil company shareowners report having ever used to acquire stock or mutual fund shares, points up, once again, their advanced age. Two methods of acquisition, gift/inheritance and stock split/dividend, are both functions of age. The older the shareowner, the greater the likelihood he/she will have acquired stock through these means. The relatively low incidence of those acquiring through employee stock purchase plans also stems from the age factor: few such plans were available to older oil company shareowners when they were employed.

Table 22

STOCK MARKET ACTIVITY OF SHAREOWNERS SINCE JANUARY 1975*

	1980 Direct Shareowners
Bought more stock than sold	46%
Sold more stock than bought	9
Bought and sold about equally	13
No activity, same position	28
No answer	4
	100%

---

* Unweighted

Analysis

Nearly half of oil company shareowners bought more stock than they sold, dollarwise, during the period January 1975 to May 1981. Only about 1-in-10 had a net sales balance; 13% bought and sold about equally. Nearly 3-in-10 had no activity at all.

These data indicate a strong positive attitude toward common stock, contrary to the nationwide trend of the last decade. The Exchange's national shareownership survey revealed a decline in median portfolio size from $10,100 to $4,000 between mid-1975 and mid-1980. Federal Reserve Board data show the individual sector disinvesting $35.5 billion of stock over roughly the same period, while in the 1970-75 period, $21.0 billion of stock was liquidated.

Table 23

STOCK MARKET ACTIVITY OF SHAREOWNERS SINCE MOST RECENT REDUCTION IN CAPITAL GAINS TAX*

	1980 Direct Shareowners
Bought more stock than sold	29%
Sold more stock than bought	9
Bought and sold about equally	15
No activity, same position	42
No answer	5
	100%

---

* Unweighted

Analysis

Most noteworthy is the positive response individual oil company shareowners obviously had to the reduction in capital gains taxes in early 1979. Comparing Table 24 results to those in Table 23, the proportion reporting net buying since the reduction in capital gains taxes in early 1979 is relatively greater (considering the shorter time frame) than the proportion reporting net buying over the entire 1975-1981 span.

Table 24

USE OF PROCEEDS OF SALE BY SHAREOWNERS WHO SOLD MORE THAN BOUGHT SINCE JANUARY 1975*

	1980 Direct Shareowners
Invested outside the stock market	72%
Used for day-to-day expenses	14
Spent otherwise	14
	100%

---

* Unweighted

Analysis

Among shareowners who sold more stock than they bought, better than 7-in-10 said they reinvested the sales proceeds outside the stock market. Half of the remaining net sellers used their sales proceeds for day-to-day expenses, and the other half spent them otherwise.

Table 25

PARTICIPATION BY SHAREOWNERS IN DIVIDEND REINVESTMENT PLANS OF COMPANIES WHOSE STOCK IS OWNED*

	1980 Direct Shareowners
Participate	33%
Don't participate	67
	100%

---

* Unweighted

Analysis

One-third of oil company shareowners participate in the dividend reinvestment plans of companies whose stock they own. The majority participate in only one or two plans, but many participate in three or more. Fully 20% participate in five plans or more.

Table 26

NUMBER OF DIVIDEND REINVESTMENT PLANS PARTICIPATED IN BY SHAREOWNERS*

	1980 Direct Shareowners
One company	28%
Two companies	26
Three companies	13
Four companies	8
Five companies	4
Six companies	5
Seven companies	2
Eight companies	4
Ten and over	5
No answer	5
	100%

---

* Unweighted

Table 27

PROPORTION OF DIVIDENDS REINVESTED, SAVED AND/OR SPENT

REINVESTED N = 408		SAVED		SPENT	
More than 50%	9%	From 25 to 50%	8%	Less than 25%	8%
		Less than 25%	92%	From 25 to 50%	8%
				Less than 25%	84%
From 25 to 50%	14%	More than 50%	12%	From 25 to 50%	7%
				Less than 25%	5%
		From 25 to 50%	61%	From 25 to 50%	41%
				Less than 25%	20%
		Less than 25%	27%	More than 50%	9%
				From 25 to 50%	18%
Less than 25%	77%	More than 50%	26%	From 25 to 50%	6%
				Less than 25%	20%
		From 25 to 50%	23%	More than 50%	8%
				From 25 to 50%	15%
		Less than 25%	51%	More than 50%	51%

Analysis

The bulk of oil company shareowners spend much of the cash dividends they receive from various stockholdings.

Fewer than 1-in-10 oil company shareowners reinvest more than 50% of their cash dividends. The great majority -- better than three out of four investors -- reinvest less than 25% of cash dividends; the remaining investors (14%) reinvest from 25% to 50%.

Among the 77% of oil company investors reinvesting less than 25% of their dividends, the majority save less than 25%, spending the cash for such expenses as a TV, automobile or vacation. About one-quarter save from 25% to 50%, with the majority of these (15%) spending another 25% to 50%.

Of those investors who choose a middle-ground and reinvest from 25% to 50% of their dividends, 61% also save an equal amount. Better than one-in-four save less than 25%.

Of the small minority (9%) who reinvest half their dividends, almost all (92%) save less than 25% of the remainder.

Table 28

PROPORTION OF SHAREOWNERS PARTICIPATING IN VARIOUS FINANCIAL VEHICLES

	1980 Direct Shareowners*	12.1 Million Stockowning** 1977 Households
Listed common stock	93%	100%
Passbook savings account	79	93
Own home	75	92
Insurance on real or personal property	67	NA
Life insurance on self	56	95
Savings certificates	36	53
Preferred stock	35	25
Money market mutual funds	33	6
Real estate other than home	29	39
U.S. savings bonds	25	60
Stock mutual funds	25	26
Municipal bonds	23	10
Tangibles (gold, gems, art, etc.)	20	44
U.S. Treasury bills	19	7
Corporate bonds	18	13
Unlisted common stock	18	27
Income from estate or trust	15	NA
Employer or union pension fund	15	NA
Long-term U.S. bonds	12	9
Annuities	12	17
Mutual savings bank	12	NA
IRA/Keogh plan	11	24
Tax-free mutual funds	11	7
Ownership in a private company	11	26
Negotiable certificates of deposit	9	NA
Convertible securities	9	16
Employee savings plan	7	41
Common trust fund (bank)	6	NA
Tax shelters	6	4
State or municipal retirement fund	5	NA
Employee profit-sharing plan	5	33
Options	4	4
Warrants	3	2
Commodity contracts	NA	1

---

* Unweighted

** Public Attitudes toward Investing - Marketing Implications, NYSE 1977, Appendix 4-7 (excludes households with income of less than $10,000).

COMPARISON TO 1974 STUDY

Estimated direct shareownership in the six largest oil companies for 1980 is 2,071,000, down about 235,000 since the 1974 study. An estimated 60,000 of this loss is the result of reduced numbers of owners through street name holdings. Ownership through employee plans rose an estimated 10,000. The bulk of the loss, 185,000, resulted from fewer shareowners in named accounts. Greater reductions to eliminate double-counting of shareowners who owned more than one of the six oil companies were primarily responsible for the lower estimate of net unduplicated shareowners.

As detailed in the Methodology, the procedures for conducting the 1980 study had to be changed in many respects from those used in 1974. A major change occurred in the unduplication of multi-oil-company shareowners. Here, procedural refinements resulted in a larger reduction, proportionately, than took place in 1974: shareowners were reduced by nearly 651,000, about 33% of the total in 1980 compared to 425,000 or 22% in 1974. As a result, the change from 1974 to 1980 netted to a loss of 185,000 shareowners.

Had the identical unduplication techniques been used in both 1974 and 1980, the net loss of 185,000 might have been reduced or eliminated entirely. Most likely, the directional change in shareownership for these companies over these years is too small to determine satisfactorily. Actual stockholder-of-record (SOR) counts supplied by the six largest oil companies (Table 29a) rose by only 69,000 and the bulk of this gain was in the areas of foreign and non-individual record holders. Little, if any, growth took place in direct individual domestic shareownership during the 1974-1980 period. Over the six years, these companies reported a rise to 1,996,000 SOR's, representing a net gain of only 26,000 such SOR's or less than 750 per company, per year on average.

Table 29

ESTIMATE OF DIRECT SHAREOWNERS IN THE SIX LARGEST U.S. OIL COMPANIES

	1980	1974
Shareowners in named shareowner accounts	1,665,000	1,850,000
Shareowners in street name accounts	266,000	326,000
Shareowners through oil company savings plans	140,000	130,000
Total direct shareowners	2,071,000	2,306,000

Table 29a

ESTIMATE OF DIRECT SHAREOWNERS IN NAMED ACCOUNTS

	1980	1974
Total stockholders-of-record	2,118,000*	2,049,000*
Less foreign stockholders-of-record and non-individual stockholders	- 122,000	- 79,000
Total individual domestic SOR	1,996,000	1,970,000
Additional shareowners in multiple-owned accounts (less intra-company duplication)	+ 320,000	+ 301,000
	2,316,000	2,275,000
Less estimated inter-company duplication	- 651,000	- 425,000
Estimated net unduplicated shareowners in named shareowner accounts	1,665,000	1,850,000

---

* Total for six companies as of August of 1980 and third quarter of 1974 record dates.

Table 29b

ESTIMATE OF DIRECT SHAREOWNERS IN STREET NAME ACCOUNTS

	1980	1974
Estimated shareowners in street name accounts unduplicated on inter and intra-company basis	301,000	388,000
Less estimated shareowners owning in own and street names	-35,000	-62,000
Net number of direct shareowners owning through street name stock	266,000	326,000

Table 29c

ESTIMATE OF DIRECT SHAREOWNERS THROUGH EMPLOYEE SAVINGS PLANS

	1980	1974
Shareowners enrolled in employee plans	156,000	144,000
Less employees owning through named shareowner accounts	-16,000	-14,000
Employee plan shareowners	140,000	130,000

Table 30

DEMOGRAPHIC PROFILE OF TYPICAL DIRECT SHAREOWNERS OF SIX LARGEST OIL COMPANIES

	1980	1974
Sex	Female (56%)	Female (54%)
Median age	62.7 yrs.	60.4 yrs.
Median household income*	$29,300	$16,400**
Median years of education	16.1 yrs.	14.7 yrs.
Occupation	Not employed: Retiree/ housewife	Not employed: Retiree/ housewife
Marital status	Married	Married
Median portfolio value	$41,500	$20,000
Likely residence	Middle Atlantic state	Middle Atlantic state

---

* 1979 and 1973 incomes respectively.

** Equivalent to $26,800 in 1979 dollars.

Analysis

With few exceptions, the shareowner base of the six largest oil companies has not changed noticeably since the 1974 study. Females still predominate in number, and some further aging is evident. Median household income is up, even allowing for the effects of inflation. Educational levels are higher, but retirees and housewives still constitute the basic (non-) occupational cadre. Portfolio values have more than doubled since the 1974 survey. The Middle Atlantic states accounted for a considerably greater proportion of total shareownership, moving up from 20.9% in 1974 to 25.1% in 1980.

SIX LARGEST OIL COMPANIES PARTICIPATING IN 1980 AND 1974 STUDIES

Exxon Corporation

Gulf Oil Corp.

Mobil Corporation

Standard Oil Co. of California

Standard Oil Co. (Indiana)

Texaco Inc.

METHODOLOGY

For its Shareownership 1981 survey, the Exchange dropped its alpha-seg survey approach and developed a new methodology. This methodology produces estimates of the direct U.S. shareowning population by means of incidence ratios from a standard telephone survey among all telephone households in the country. This is a feasible approach on a national level, because the incidence of shareownership in the population is relatively high -- about one in five households. The incidence of direct oil company shareownership, however, is lower: about one in 35.

Of necessity then, a completely new methodology -- different from the Exchange's national survey and from that employed in the 1974 API survey -- was developed to estimate the total number of direct shareowners for this study. Estimates of intra-company shareownership are based on samples of individually-named shareowner accounts from the sixteen oil companies. The direct shareowners estimated in this study are defined as fiduciary and non-fiduciary individuals in single name and joint account records of the sixteen oil companies participating in this study as of August 1980. For further details on account definitions, see "Special Instructions," Exhibit B.

Inter-company estimates were made by applying the results of a telephone survey to the intra-company estimates. Demographic and financial characteristics were obtained from the same telephone survey. Supporting surveys were conducted to verify the representativeness of the primary (telephone) survey, to supply unduplication statistics between direct and indirect shareowners and to obtain additional financial characteristics. The Exchange's own shareownership survey was used to determine street name ownership in the sixteen oil companies. Information on shareownership via employee stock purchase plans was obtained directly from the oil companies.

The procedures used to estimate indirect oil company shareownership are fully detailed in each of the specific segments comprising the indirect ownership report.

Collection of Oil Companies' Data

As a first step in developing this estimate of direct shareowners in the sixteen participating major oil companies, a form (Form A) was completed by each company which resulted in the total data shown in Exhibit B-1.

In addition, each company was requested to draw, on an Nth name basis in groups of ten consecutive names, a 1% sample of domestic individuals (males and females combined), joint accounts and fiduciary individuals. Each company drew its sample from a different starting point on its lists to avoid alphabetical bias. The aggregate of these samples was 32,822 stockholder records.

Intra-Company Unduplication

All 32,822 stockholder records were reviewed. These included single name males and females, joint accounts and minors. Duplicates within the same household were eliminated, and single records representing multiple shareowners were expanded. This procedure resulted in a net expansion to 38,293 unduplicated shareowners or 16.7% on an intra-company basis.

Sample Design and Selection

The composite list was again examined to establish male vs. female percentages and to create a geographic profile. Both profiles were then combined to provide a template for sample selection. Minors and those whose sex was indeterminable were eliminated from the sample.

A total of 36,137 eligible adult male and female potential respondents resulted from the profile effort. From this pool, a sample of 3,600 names was drawn on an Nth name basis, then balanced by the male/female proportion for each of the 16 companies. The sample was then distributed geographically over the 50 states and again balanced for the male/female population of each state.

Telephone Survey Procedure

The firm of Brehl and Associates of Great Neck, New York was engaged to do the national telephone survey. Their objective was to obtain 800 completed interviews with a male/female and geographic balance proportionate to the total sample balance.

Brehl and Associates ascertained telephone numbers and randomly selected from the 3,600 name sample until 802 interviews were completed in proportion to the desired sample balance.

A 15-minute telephone questionnaire (Exhibit A) was executed. Of the 3,600 name sample, telephone numbers could not be found for 334; another 367 were reached but refused the interview outright; 58 refused to complete the interview after one or more questions; 84 claimed not to be oil company shareowners; 802 completed the interviews, while 1,645 names were not needed.

Mail Surveys

Mail surveys of three different groups of shareowners were undertaken. Two were made to obtain data from those who refused a telephone interview and those for whom telephone numbers were unavailable or unlisted (plus residents of Alaska and Hawaii). These groups were contacted as part of a verification process to insure that shareowners without telephones and those who refused to be interviewed by telephone had similar characteristics and opinions to participants.

A total of 690 questionnaires (Exhibit C) were mailed April 27, 1981; returns received after May 29th (cut-off date) were not used. The following tabulation summarizes these mailing efforts.

	Mailed	Received	Percentage
Telephone refusals	356	157	44%
No telephone	334	168	50
Total	690	325	47%

With the exception of some under-representation among shareowners with the highest incomes, telephone survey respondents were quite similar to non-respondents and the survey results are considered representative. Comparisons between the demographics of telephone survey respondents and those respondents to the mail survey (telephone refusals plus no-telephone respondents) are shown in Tables A through E.

In addition to the necessary demographics to verify the representativeness of the telephone survey results, both groups were asked questions to supplement data on financial characteristics. Results of these questions were combined with those from the mail survey among telephone respondents. Together they comprise an additional body of information on direct oil company shareowners.

The third survey was directed to a subsample of telephone respondents. The primary purpose was to provide inter-company unduplication factors as a means of obtaining the net number of individuals owning oil company stock indirectly. Also important were a series of questions seeking additional data regarding financial characteristics on direct ownership.

A 38% random subsample was selected from respondents. A total of 312 questionnaires were mailed April 27, 1981, and 238 returns (76%) were returned by May 29. The questionnaire (Exhibit D) repeated certain telephone questions, as well as expanding some questions and adding others. Answers to demographic questions identical to those asked on the telephone showed this telephone subsample to be representative of all telephone respondents (see Tables F-I).

Inter-Company Unduplication

Results of Q.2b on the telephone interviews were essential for estimating the number of direct shareowners owning one, two or more oil companies and for weighting the survey results. In unduplicating for inter-company shareownership, the estimates of the net number of individuals owning one or more of the sixteen companies' stock were developed on the basis of a method originally described in 1964 by Dr. Seymour Kwerel, Professor of Statistics at Baruch College, New York. This procedure has been utilized for many years by major advertising agencies for the estimation of unduplicated media audiences, since it permits use of a much shorter, and less costly, interview than might normally be required.

A net population wherein an individual can qualify on the basis of either a single criterion or multiple criteria (in this case, ownership of stock in one or several oil companies) can be very closely estimated from data giving only the single gross frequencies (in this case, total people owning each stock) and a subsample of the many possible pairs (see Table 32). The procedure is valid whether internal duplication is random or not.

Dr. Kwerel personally performed the complex algorithms necessary for this study. The demographic profiles computed by Dr. Kwerel for the unduplicated owner population of the sixteen companies were used to derive a set of weighting, i.e. adjustment factors on the basis of the two characteristics, age and income, that proved to show the greatest differences between the gross owner profile and the net. A single-dimension adjustment was impossible because of the complex interrelationship between the two characteristics.

The procedure used for the two-dimensional adjustment was the iterative technique utilizing successive sets of geometric means of the marginals to adjust the two-dimensional cells. Adequate convergence was reached with the fifth iteration, and the resultant factors were multiplied by a constant to bring the result of their use into agreement with Dr. Kwerel's net projection.

These factors were used as multipliers against the projected weighted data already produced on the base of 749 claimed source list owners. The overall weight for any given respondent is the product of his source list weight times the adjustment factor for his age/income cell from Table 31 below. Weighting of the survey data was under the supervision of Thomas T. Semon, statistical consultant for the Exchange's 1980 shareownership survey.

Table 31

	Age			
Income	Under 45	45 - 54	55 - 64	65 +
Under $15,000	.779	.791	.662	.644
$15 - 24,000	.705	.711	.589	.570
$25 - 34,000	.730	.736	.613	.595
$35 - 49,000	.724	.742	.613	.589
$50,000 & Over	.638	.644	.539	.515
NA	.656	.656	.546	.527

Table 32

Company		Total				List #1		List #2		Neither List			
#1	#2	Pair Exposure	Own #1	Own #2	Own Both	Pair Exposure	Own #2	Pair Exposure	Own #1	Pair Exposure	Own #1	Own #2	Own Both
A	B	408	155	137	48	73	15	88	18	247	64	34	15
	C	407	155	110	33	68	5	72	15	267	72	33	13
	D	415	158	107	46	69	12	68	23	278	66	27	11
	E	410	167	95	41	70	8	61	17	279	80	26	16
	F	412	170	84	39	75	6	59	21	278	74	19	12
	G	392	154	85	39	69	10	52	19	271	66	23	10
	H	383	155	52	5	73	4	41	--	269	82	7	1
	I	382	151	69	35	72	10	42	15	268	64	17	10
	J	197	76	39	15	35	3	31	9	131	32	5	3
	K	107	37	21	1	14	--	20	--	73	23	1	1
	L	102	47	24	8	19	2	21	6	62	22	1	--
	M	98	41	25	3	18	--	21	1	59	22	4	2
	N	100	40	15	4	19	--	13	4	68	17	2	--
	O	102	41	12	4	18	1	9	3	75	20	2	--
	P	95	33	9	3	18	--	9	3	68	12	--	--
B	C	213	74	57	21	45	9	36	7	132	22	12	5
	D	206	71	48	13	45	3	35	5	126	21	10	5
	E	102	36	26	10	21	3	17	3	64	12	6	4
	F	211	68	40	10	46	1	27	3	138	19	12	6
	G	100	30	24	4	22	2	12	--	66	8	10	2
	H	195	63	24	4	43	2	21	1	131	19	1	1
	I	197	69	39	12	42	3	23	4	132	23	13	5
	J	111	38	18	3	24	1	14	2	73	12	3	--
	N	100	30	15	4	22	1	13	3	65	5	1	--
	O	102	36	12	2	21	--	9	1	72	14	3	1
	P	95	33	9	--	21	--	9	--	65	12	--	--

Table 32 (Continued)

Company		Total				List #1		List #2		Neither List			
#1	#2	Pair Exposure	Own #1	Own #2	Own Both	Pair Exposure	Own #2	Pair Exposure	Own #1	Pair Exposure	Own #1	Own #2	Own Both
C	D	218	60	50	7	38	1	33	4	147	13	16	2
	E	210	55	50	15	38	6	33	6	139	11	11	3
	F	112	31	19	2	18	1	14	1	80	12	4	--
	G	194	53	38	5	36	2	26	1	132	16	10	2
	H	86	24	12	2	16	--	10	--	60	8	2	2
	I	189	50	33	3	34	1	20	2	135	14	12	--
	J	197	55	39	10	34	1	31	7	132	14	7	2
	K	107	29	21	--	20	--	20	--	67	9	1	--
	O	102	26	12	2	18	--	9	--	75	8	3	2
D	E	209	59	47	6	33	1	30	1	146	25	16	4
	F	213	55	40	7	34	1	30	3	149	18	9	3
	G	107	27	20	4	16	1	14	2	77	9	5	1
	H	197	57	28	4	35	--	21	3	141	19	7	1
	I	95	25	20	6	18	1	12	2	65	5	7	3
	J	111	23	18	1	17	--	14	1	79	5	4	--
	K	107	27	21	6	16	--	20	5	71	6	1	1
	L	102	32	24	7	17	1	21	5	64	10	2	1
	P	95	25	9	1	18	--	9	1	68	6	--	--
E	F	201	45	44	11	28	1	32	7	141	10	11	3
	G	206	46	43	9	30	2	28	3	148	13	13	4
	H	102	23	16	3	14	1	10	-	78	9	5	2
	I	201	48	35	4	31	2	21	1	149	16	12	1
	K	107	24	21	2	16	--	20	2	71	6	1	--
	L	102	23	24	2	14	--	21	1	67	8	3	1
	M	98	22	25	1	14	--	21	1	63	7	4	--
	O	102	26	12	2	17	2	9	--	76	9	1	--

Table 32 (Continued)

Company		Total				List #1		List #2		Neither List			
#1	#2	Pair Exposure	Own #1	Own #2	Own Both	Pair Exposure	Own #2	Pair Exposure	Own #1	Pair Exposure	Own #1	Own #2	Own Both
F	G	199	44	47	9	29	4	26	3	144	12	17	2
	H	202	42	28	2	29	1	20	--	153	13	7	1
	I	99	23	16	4	16	3	10	1	73	6	3	--
	J	111	19	18	3	14	1	14	2	83	3	3	--
	L	102	21	24	2	16	--	21	1	65	4	3	1
	M	98	23	25	5	16	2	21	3	61	4	2	--
	N	100	21	15	2	13	--	13	2	74	6	2	--
G	H	186	42	24	2	24	--	20	1	142	17	4	1
	I	185	41	30	6	26	2	19	2	140	13	9	2
	J	86	18	21	3	12	1	17	1	57	5	3	1
	K	107	20	21	1	14	1	20	--	73	5	--	--
	M	98	23	25	3	14	--	21	1	63	8	4	2
	N	100	24	15	4	12	1	13	3	75	9	1	--
H	I	181	24	34	--	21	--	21	--	139	3	13	--
	J	86	12	21	--	10	--	17	--	59	2	4	--
	L	102	16	24	1	10	--	21	1	71	5	3	--
	N	100	12	15	--	10	--	13	--	77	1	2	--
	P	95	12	9	--	11	--	9	--	75	1	--	--
I	J	86	14	21	3	9	1	17	1	60	4	3	1
	M	98	16	25	3	10	2	21	1	67	5	2	--
	O	102	19	12	1	11	--	9	1	82	7	3	--
	P	95	20	9	1	12	--	9	1	74	7	--	--

Direct Shareowners in Street Name Accounts

Data from the New York Stock Exchange's 1980 Survey of Shareownership showed that 13.5% of shareowners hold all their oil company stock in "street name," and 1.8% hold some oil company stock in street name and some in their own names.

Applying this factor of 15.3% of shareowners in street name against the unduplicated (intra and inter-company) total of 2,330,000 direct shareowners of the sixteen oil companies, produced a total of 421,000 shareowners in street name. However, a portion (11.8%) of these also have oil company shares in their own names. Therefore, since they have been duplicated in named accounts, 50,000 shareowners were deducted from the street name total. The result was an unduplicated total shareowner estimate for street name accounts of 371,000 (see Table 1b).

Direct Shareowners in Employee "Savings" Plans

Each of the sixteen participating companies supplied data on its various plans, if any, whereby employees might purchase company stock with voting rights. Fourteen of the sixteen companies had some stock acquisition plans, with an estimated total of 378,000 employee-participants.

Discussion with company officials concerned with the area of employee stockownership revealed that approximately 10% of participants probably also had shares under their own names. This concurred with a similar finding from the 1974 study.

After adjustment, the net number of unduplicated stockholders owning shares through employee savings plans was estimated to be 340,000 (see Table 1c).

Table A

SEX OF SHAREOWNERS

	1980 Direct Shareowners	
	Telephone Survey	Non-Participants*
	N = 802	N = 325
Male	46%	44%
Female	54	56
	100%	100%

---

* Unweighted

Table B

AGE OF SHAREOWNERS

	1980 Direct Shareowners	
	Telephone Survey	Non-Participants*
	N = 802	N = 325
Under 21	--%	--%
21 - 24	--	--
25 - 34	5	6
35 - 44	8	6
45 - 54	14	11
55 - 64	23	20
65 - 74	29	28
75 and over	20	23
No answer	1	5
	100%	100%

---

* Unweighted

Table C

HOUSEHOLD INCOME OF SHAREOWNERS

	1980 Direct Shareowners	
	Telephone Survey	Non-Participants*
	N = 802	N = 325
Under $10,000	7%	5%
$10,000 - $14,999	8	8
$15,000 - $19,999	9	10
$20,000 - $24,999	9	8
$25,000 - $34,999	15	14
$35,000 - $49,999	15	17
$50,000 - $99,999	10	18
$100,000 and over	4	9
No answer	22	11
	100%	100%
Median Household Income	$35,200	$43,200

---

* Unweighted

Table D

EDUCATION OF SHAREOWNERS

	1980 Direct Shareowners	
	Telephone Survey	Non-Participants*
	N = 802	N = 325
Some elementary school	--%	2%
Completed elementary school	2	3
Some high school	5	6
Completed high school	17	13
Some college	16	18
Business or technical school	7	9
Completed college	32	24
Graduate study	20	22
No answer	1	3
	100%	100%

---

* Unweighted

Table E

MARITAL STATUS OF SHAREOWNERS

	1980 Direct Shareowners	
	Telephone Survey	Non-Participants*
	N = 802	N = 325
Married	67%	66%
Single	9	8
Separated	--	--
Widowed	20	19
Divorced	3	2
No answer	1	5
	100%	100%

---

* Unweighted

Table F

SEX OF SHAREOWNERS

	1980 Direct Shareowners	
	Telephone Survey	Telephone Sub-sample*
	N = 802	N = 238
Male	46%	48%
Female	54	52
	100%	100%

---

* Unweighted

Table G

AGE OF SHAREOWNERS

	1980 Direct Shareowners	
	Telephone Survey	Telephone Sub-sample*
	N = 802	N = 238
Under 21	- %	- %
21 - 24	-	-
25 - 34	5	6
35 - 44	8	7
45 - 54	14	16
55 - 64	23	22
65 - 74	29	27
75 and over	20	22
No answer	1	-
	100%	100%

---

* Unweighted

Table H

HOUSEHOLD INCOME OF SHAREOWNERS

	1980 Direct Shareowners	
	Telephone Survey	Telephone Sub-sample*
	N = 802	N = 238
Under $10,000	7%	7%
$10,000 - $14,999	8	6
$15,000 - $19,999	9	11
$20,000 - $24,999	9	5
$25,000 - $34,999	15	23
$35,000 - $49,999	15	20
$50,000 - $99,999	10	18
$100,000 and over	4	7
No answer	22	3
	100%	100%
Median Household Income	$35,200	$40,700

---

* Unweighted

Table I

MARITAL STATUS OF SHAREOWNERS

	1980 Direct Shareowners	
	Telephone Survey	Telephone Sub-sample*
	N = 802	N = 238
Married	67%	63%
Single	9	9
Separated	-	-
Widowed	20	22
Divorced	3	4
No answer	1	2
	100%	100%

---

* Unweighted

Reliability of Survey Percentages

Results of any sample are subject to sampling variation. The magnitude of the variation is measurable and is affected by the number of interviews and the level of the percentages expressing the results.

The table below shows the possible sample variation that applies to percentage results reported in this study. The chances are 95-in-100 that results would not vary, plus or minus, by more than the indicated number of percentage points from the result that would be obtained if the interviews were repeated using the same sampling procedures.

APPROXIMATE SAMPLING TOLERANCES APPLICABLE TO PERCENTAGES AT OR NEAR THESE LEVELS*

Size of Sample on Which Survey Result is Based	10% or 90%	30% or 70%	50%
2,000 interviews	± 2%	± 3%	± 3%
1,500 interviews	± 2	± 3	± 3
1,200 interviews	± 2	± 3	± 3
1,000 interviews	± 2	± 4	± 4
800 interviews	± 3	± 4	± 4
500 interviews	± 3	± 5	± 5
250 interviews	± 5	± 7	± 8
100 interviews	± 7	±11	±12

---

* Based on 95 chances in 100

Sampling Tolerances when Comparing Two Subsamples

Tolerances are also involved in the comparison of results from different parts or groups of any one sample. A difference, in other words, must be of at least a certain size to be considered statistically significant. The table below is a guide to the sampling tolerances applicable to such comparisons.

DIFFERENCES REQUIRED FOR SIGNIFICANCE AT OR NEAR THESE PERCENTAGE LEVELS*

Size of Samples Compared	10% or 90%	30% or 70%	50%
2,000 and 2,000	2%	4%	4%
1,000 and 1,000	3	5	6
1,000 and 500	4	6	7
500 and 500	5	7	8
500 and 200	6	9	10
200 and 200	7	11	12
200 and 100	9	14	15
100 and 100	10	16	17

---

* Based on 95 chances in 100

3a. Do you currently have or invest in any of the following? (Check all that apply)

( ) Listed common stock
( ) Stock mutual funds
( ) Unlisted common stock
( ) Preferred stock
( ) Employer or Union pension fund
( ) State or municipal retirement fund
( ) IRA/Keogh Plan
( ) Common trust fund (bank)
( ) Income from an estate or trust
( ) Annuities
( ) Long-term U.S. bonds
( ) Municipal bonds
( ) Convertible securities
( ) U.S. Treasury bills
( ) Corporate bonds
( ) Tax-free mutual funds
( ) Tax Shelters
( ) Money market mutual funds
( ) Options
( ) Warrants
( ) Commodity contracts
( ) Life insurance on yourself
( ) Insurance coverage on real or personal property
( ) Passbook savings account
( ) Mutual savings bank (depositor)
( ) Own home
( ) Real estate other than home
( ) U.S. savings bonds
( ) Employee savings plan
( ) Employee profit-sharing plan
( ) Savings certificates
( ) Negotiable certificates of deposit
( ) Ownership in a private company
( ) Tangible investments (gold, silver, gems, art, coins, etc.)

NON-SHAREOWNERS, PLEASE SKIP TO QUESTION 9;
SHAREOWNERS, PLEASE CONTINUE WITH QUESTION 3b.

3b. If you are a shareowner in any public oil corporation, please check each of the oil companies listed below in which you currently own any shares of common or preferred stock; shareowners who do not own oil company shares, please check either of last two choices.

Yes, own ( ) Ashland Oil, Inc.
( ) Atlantic Richfield Company
( ) Cities Service Company
( ) Conoco Inc.
( ) Exxon Corporation
( ) Gulf Oil Corporation
( ) Mobil Corporation
( ) Occidental Petroleum Corporation
( ) Phillips Petroleum Company
( ) Standard Oil Co. of California
( ) Standard Oil Co. (Indiana)
( ) Standard Oil Co. (Ohio)
( ) Sun Company, Inc.
( ) Tenneco Inc.
( ) Texaco Inc.
( ) Union Oil Co. of California
( ) None of above, but own some other oil company stock

No. ( ) DON'T OWN ANY OIL COMPANY STOCK NOW, but previously owned.
( ) NEVER owned any oil company stock (please skip to Question 6a).

Please check the type of stock issue being reported

☐ COMMON ☐ PREFERRED

CONFIDENTIAL

FORM A - Stockholder

Names and Addresses

1980 SURVEY OF SHAREOWNERS
AMONG PARTICIPATING MEMBERS OF THE AMERICAN PETROLEUM INSTITUTE

GENERAL INSTRUCTIONS

Please fill out and attach this form to your list of stockholder names, addresses and tax identification numbers selected in accordance with instructions below. Be sure to use a separate Form A for each common and preferred stock issue outstanding.

ACCOUNT/RECORD ESTIMATE

To estimate the number of accounts you will generate, use the following procedure:

Sum of lines 04,05 and 06 from Form B: ______________

Multiply by 1% (10 accounts per 1,000): X ______ .01

Total number of sample accounts to be supplied: ______________

ACCOUNT/RECORD SELECTION

Please sort/array accounts/records alphabetically within ZIP code order, then complete the following steps:

1) Select only individual male, female and joint accounts (types 04,05 and 06 from Form B).

2) Skip the first ____ of these accounts.

3) Select and print the next ten (10) accounts.

4) Skip the next 990 accounts, then repeat step (3).

5) Repeat steps (3) and (4) until all individual male, female and joint accounts have been processed.

(Over Please)

ACCOUNT LISTING INSTRUCTIONS

For each individual stockholder account, report the COMPLETE NAME, ADDRESS AND TAX IDENTIFICATION NUMBER (TIN). PLEASE BE SURE TO INCLUDE ZIP CODES IN THE ADDRESSES.

JOINT ACCOUNTS are defined as two or more individuals, such as a joint tenancy, tenancy in common, tenancy by the entirety and similar accounts. Include the complete name and address of all persons who appear in the joint registration.

FIDUCIARY INDIVIDUALS (AND FIDUCIARY JOINT ACCOUNTS) include persons acting as custodians for minors under "Gift to Minors" statutes, guardians for individuals, unincorporated estates and trustees -- whether or not the beneficiaries are individuals, institutions, or are unknown.

FORWARDING NAMES AND ADDRESSES

We request that names, addresses and tax identification numbers be submitted on either cards, machine listings or typewritten sheets. Format the listing in the conventional mailing format with the TIN above the name and address, as if you were going to notify each individual stockholder of a company action.

Please be sure to enclose a copy of Form A showing the name of the stock issue from which the names, addresses and tax identification numbers are drawn.

Your completed forms, along with the names, addresses and tax identification numbers, should be forwarded to the Business Research Department, New York Stock Exchange, Inc., 11 Wall Street, New York, N.Y. 10005 as soon as possible, but not later than September 9, 1980.

Name of Company	Name of Reporting Officer
Address	Title
Title or Designation of Stock Issue	Date __________

BREHL & ASSOCIATES MARKETING RESEARCH CO., INC., 107 NORTHERN BLVD., GREAT NECK, NY 11021

ENERGY STUDY -- Job #50-1-80

EXHIBIT A

NUMBER DIALED: ______________________ TIME STARTED: ____ P.M.

1 5

ASK FOR SPECIFIC PERSON LISTED.

READ IN 6-7

Hello. I'm calling from New York City. We're doing a study on energy-related matters, and I'd like to ask you several questions.

1. First, would you agree or disagree that . . .

	AGREE$_6$	DISAGREE$_7$
THE ENERGY SHORTAGE IS ARTIFICIAL	☐1	☐1
THE CABINET DEPARTMENT OF ENERGY SHOULD BE ABOLISHED	☐2	☐2
SYNTHETIC FUELS DEVELOPMENT SHOULD BE LEFT ENTIRELY TO THE PRIVATE ECONOMY	☐3	☐3
THE GOVERNMENT SHOULD LIMIT THE QUANTITY OF OIL IMPORTED INTO THIS COUNTRY	☐4	☐4
MORE EXPLORATION FOR OIL AND NATURAL GAS SHOULD BE PERMITTED ON FEDERAL LANDS	☐5	☐5
PRICE CONTROLS ON NATURAL GAS SHOULD BE ELIMINATED IMMEDIATELY	☐6	☐6
OIL COMPANIES EARN EXORBITANT PROFITS	☐7	☐7
OIL COMPANIES ARE RESPONSIBLE FOR HIGH GASOLINE AND FUEL OIL PRICES	☐8	☐8
THE SO-CALLED "WINDFALL PROFITS TAX" ON DOMESTIC OIL SHOULD BE REPEALED	☐9	☐9
TO INCREASE U.S. ENERGY PRODUCTION, ENVIRONMENTAL REGULATIONS SHOULD BE RELAXED SOMEWHAT	☐0	☐0

____ 8

You may be interested to know that you are taking part in a major study being conducted for the New York Stock Exchange. You will not be asked to buy anything and names of respondents will never be revealed. (If necessary, tell respondent a collect call may be made to the NYSE between 9:00 A.M. and 2:00 P.M. -- Telephone (212) 269-2190.)

READ IN 9-10

2a. Now I'd like to ask you about stock in public oil corporations -- that is, shares of common or preferred oil company stock that are publicly-traded either on an exchange or over the counter. Do you, yourself, now own . . . (READ LIST)?

	YES$_9$	NO$_{10}$
ANY SUCH OIL COMPANY SHARES THAT YOU BOUGHT YOURSELF	☐1	☐1
ANY THAT YOU INHERITED	☐2	☐2
ANY THAT YOU RECEIVED AS A GIFT OR BONUS	☐3	☐3
ANY THAT YOU ACCUMULATED UNDER AN EMPLOYEE STOCK PURCHASE OR OPTION PLAN	☐4	☐4

____ 11

IF ANY "YES" AT Q.2a, ASK Q.2b.
OTHERWISE, GO TO Q.2c.

2b. Do you, yourself, currently own shares in any of the following oil company stocks?

6 OUT OF THE 16
PARTICIPATING COS.
WERE READ TO RESPONDENT.

YES	NO
☐	☐
☐	☐
☐	☐
☐	☐
☐	☐
☐	☐

(1)

2c. Have you sold any oil company stock in the past eight months (since June 1980)?

YES ☐ 1 12
NO ☐ 2

3a. Does anyone else in your household, including minors at home or away, now own any such oil company shares either singly or jointly with someone else, including any held for them by a custodian?

IF ANY "YES" AT Q.2a, ASK Q.3b NEXT.
OTHERWISE, ARRANGE INTERVIEW WITH OTHER ADULT OIL COMPANY SHAREOWNER -- START NEW INTERVIEW FROM Q.1 & ATTACH THIS QUESTIONNAIRE TO IT. ← YES ☐ 1 13

IF ANY "YES" AT Q.2a, GO TO Q.4a.
OTHERWISE, TERMINATE. ← NO ☐ 2

3b. How many such adult shareowners of oil company stocks are there age 21 or over in your household, other than yourself? ____14

____ ADULT OWNERS NONE ☐ ____15

3c. How many such minor shareowners of oil company stocks are there under the age of 21 in your household?

____ MINOR OWNERS NONE ☐ ____16

4a. Do you own your oil company shares alone (singly) or jointly (with someone else)?

ALONE ☐ 1 JOINTLY ☐ 2 BOTH WAYS ☐ 3 ____17

4b. Are any of your oil company shares registered in the broker's name instead of your own name -- that is, in street name as in a margin account?

18
Q.4c NEXT ← YES ☐ 1
Q.5 NEXT ← NO ☐ 2

4c. Are any of your oil company shares registered in your own name?

YES ☐ 1 19
NO ☐ 2

5. Please tell me whether you currently own any of the following specific types of investments. What about . . . (READ LIST)?

READ IN 20-21

	YES 20	NO 21
LIFE INSURANCE	☐ 1	☐ 1
INVESTMENT REAL ESTATE OTHER THAN YOUR HOME	☐ 2	☐ 2
PASSBOOK SAVINGS ACCOUNT	☐ 3	☐ 3
CORPORATE BONDS	☐ 4	☐ 4
COMMON STOCK OTHER THAN OIL COMPANY STOCK	☐ 5	☐ 5
PREFERRED STOCK OTHER THAN OIL COMPANY STOCK	☐ 6	☐ 6
STOCK MUTUAL FUNDS	☐ 7	☐ 7
MONEY MARKET FUNDS	☐ 8	☐ 8

____22

____23
____24

____25
____26

(1)

6a. Would you say the current market value you currently have invested in common and preferred stock is UNDER or OVER $25,000? I need a rough idea of the total current market value of all the shares.

29

ASK Q.6b NEXT ← UNDER $25,000 ☐1

ASK Q.6c NEXT ← $25,000 and OVER ☐2

6b. Would that be UNDER or OVER $10,000?

GO TO Q.6e < UNDER $10,000 ☐1

$10,000 AND OVER ☐2

6c. Would that be UNDER or OVER $50,000?

GO TO Q.6e ← UNDER $50,000 ☐1

ASK Q.6d NEXT ← $50,000 AND OVER ☐2

6d. Would that be UNDER $100,000 or $100,000 and OVER?

UNDER $100,000 ☐1

$100,000 AND OVER ☐2

6e. Out of the total market value of your common and preferred stocks, about what percentage is in oil company stocks? (IF NECESSARY, PROBE "Would it be more or less than 10%?" AND PROBE FURTHER TO BEST ESTIMATE)

____ %

____

____ 32

____ 33

6f. And out of the total market value of all your current investments, not including your home or personal possessions, about what percentage is in any kind of common and preferred stock? (IF NECESSARY, PROBE "Would it be more or less than 50%?" AND PROBE FURTHER TO BEST ESTIMATE)

____ %

____

____ 35

____

CLASSIFICATION DATA -- necessary for purposes of analysis

CL.1. What is your approximate age?

37

UNDER 21 ☐1

21 - 24 ☐2

25 - 34 ☐3

35 - 44 ☐4

45 - 54 ☐5

55 - 64 ☐6

65 - 74 ☐7

75 or OVER ☐8

CL.2. What was the last grade of school you completed?

38

SOME ELEMENTARY ☐1

COMPLETED ELEMENTARY SCHOOL ☐2

SOME HIGH SCHOOL ☐3

COMPLETED HIGH SCHOOL ☐4

SOME COLLEGE ☐5

BUSINESS OR TECHNICAL SCHOOL ☐6

COMPLETED COLLEGE ☐7

GRADUATE STUDY ☐8

CL.3. In which category does the total income of your household for 1980 fall -- would it be . . . ? (READ LIST)

UNDER $10,000	☐1	$ 25,000 - $34,999	☐5
$10,000 - $14,999	☐2	$ 35,000 - $49,999	☐6
$15,000 - $19,999	☐3	$ 50,000 - $99,999	☐7
$20,000 - $24,999	☐4	$100,000 and OVER	☐8

____ 3

(1)

CL.4a. What is your occupation and job title?

OCCUPATION: ____________________ → GO TO CL.5. ____40

JOB TITLE: ____________________ → GO TO CL.5. ____41

NONE ☐ ————→ ASK CL.4b NEXT

CL.4b. Are you . . . ? (READ LIST) 42

RETIRED ☐1

A STUDENT ☐2

A HOUSEWIFE ☐3

OTHER (specify): ____________________

CL.5. Are you . . . ? (READ LIST) 43

MARRIED ☐1

SINGLE ☐2

SEPARATED ☐3

WIDOWED ☐4

DIVORCED ☐5

RESPONDENT'S POSITION IN HOUSEHOLD: 44

MALE HEAD OF HOUSEHOLD ☐1

OTHER MALE ☐2

FEMALE HEAD OF HOUSEHOLD ☐3

OTHER FEMALE ☐4

You may be one of those selected to be mailed a questionnaire. Would you please watch for a questionnaire in the mail during the next several days. I'd just like to check your mailing address now.

IF RESPONDENT GIVES NAME BUT REFUSES ADDRESS, TERMINATE AND DO NOT SEND QUESTIONNAIRE.

NAME: ____________________ PHONE: ____________ ____45

MAILING ADDRESS: ____________________ ____46

CITY: ____________ STATE: ____________ ZIP: ________

DO NOT ASK FOR PERMISSION TO SEND QUESTIONNAIRE.
CHECK "DO NOT SEND QUESTIONNAIRE" ONLY WHEN RESPONDENT SPECIFIES THAT.

SEND QUESTIONNAIRE ☐ DO NOT SEND QUESTIONNAIRE ☐ ____47

THANKS VERY MUCH FOR YOUR HELP!

INTERVIEWER: ____________________ DATE: ____________

TIME ENDED: ____P.M. ____48

____49

____50

Please check the type of stock issue being reported

☒ COMMON ☒ PREFERRED

CONFIDENTIAL

FORM B

EXHIBIT B-1

Stockholders of Record Classifications

1980 SURVEY OF SHAREOWNERS

AMONG PARTICIPATING MEMBERS OF THE AMERICAN PETROLEUM INSTITUTE

Please fill out this form in accordance with instructions on the back. Be sure to use a separate Form B for each common and preferred stock issue outstanding.

STOCKHOLDERS OF RECORD AND SHAREHOLDINGS BY MAJOR CLASSIFICATIONS

Date of Record: ________

Closing Price per Share on May 30, 1975: $________

		LINE NO	NUMBER OF HOLDERS OF RECORD	NUMBER OF SHARES HELD
	TOTAL STOCKHOLDERS OF RECORD	• (01)	3,422,582	
	FOREIGN STOCKHOLDERS	(02)	29,162	
	TOTAL DOMESTIC STOCKHOLDERS	• (03)	3,393,420	
	Breakdown of Domestic Stockholders			
	INDIVIDUALS—Males & Females Combined	• (04)	2,344,731	
MAJOR	Males If Readily	• (04M)	1,059,205	
	Females Available	(04F)	1,285,526	
	JOINT ACCOUNTS	• (05)	638,008	
	FIDUCIARY INDIVIDUALS	• (06)	259,879	
	ALL OTHER—Sum of Lines (08) through (11)	(07)	150,802	
MINOR	Fiduciary Institutions	• (08)	42,944	
	Stock Brokers & Securities Dealers	• (09)	2,895	
	Nominees	• (10)	35,345	
	Institutions & Miscellaneous	• (11)	69,618	

Name of Company: Sixteen oil companies

Name of Reporting Officer: ________

Address: ________

Title: ________

Title or Designation of Stock Issue: ________

Date ________

SPECIAL INSTRUCTIONS

REPORTING PROCEDURES

Please report the number of STOCKHOLDERS OF RECORD and the number of SHARES HELD for as many of the stockholder categories shown on the reverse side of this form as your company can conveniently provide.

If your company cannot furnish a complete Form B breakdown, please report the requested data for at least Lines (01), (02), and (03); and—if at all possible—Lines (04), (05), (06), and (07), which are included in the MAJOR BREAKDOWN.

Form B data may be based on closest available record date to June 30, 1980.

Completed Form B should be forwarded to the stock exchange or other requesting organization as soon as possible, but not later than August 20, 1980.

DEFINITIONS

Line (02) – FOREIGN STOCKHOLDERS are defined as all aliens residing outside the U.S., its territories and possessions. (For Canadian and other foreign companies, U.S. citizens should be reported as **"domestic" stockholders of record.)**

Line (03) – TOTAL DOMESTIC STOCKHOLDERS include individuals,* institutions and all other non-individuals not classified as foriegn stockholders.

MAJOR BREAKDOWN OF DOMESTIC STOCKHOLDERS

Line (04) – INDIVIDUALS are non-fiduciary males and females. Do not include joint accounts [Line (05)], persons acting as custodian for minors under "Gifts to Minors" statutes [Line (06)], or fiduciary individuals and fiduciary joint accounts [Line (06)].

Line (05) – JOINT ACCOUNTS are two or more individuals, such as joint tenancy, tenancy in common, tenancy by the entirety and similar accounts.

Line (06) – FIDUCIARY INDIVIDUALS (including FIDUCIARY JOINT ACCOUNTS) are:

1. Guardians for individuals, life tenancies, pledgees, conservators, receiverships, committees for individuals, unincorporated estates, executors and administrators of estates.
2. Trustees – whether or not the beneficiaries of such accounts are individuals, institutions, or unknown.
3. Individuals acting as custodian for minors.

Fiduciary joint accounts involving an individual and an institution should be reported on Line (06) when the individual is named first in the joint registration. Where it is impossible to determine whether the fiduciary is an individual or institution, include on Line (08).

MINOR BREAKDOWN OF DOMESTIC STOCKHOLDERS
[Breakdown of Line (07)]

Line (08) – FIDUCIARY INSTITUTIONS include banks, incorporated individuals, and other non-individuals constituting a fiduciary as defined in Line (06).

Line (09) – STOCKBROKERS AND SECURITIES DEALERS are persons or organizations, except banks, registered under Federal and State laws for the purpose of purchasing and selling securities for their own account or for the account of others.

Line (10) – NOMINEES are partnerships, individuals and organizations other than stock brokers which you believe are acting as stockholders of record in behalf of other beneficial owners.

Line (11) – INSTITUTIONS & MISCELLANEOUS include colleges and universities, personal holding corporations, financial institutions such as life insurance companies, investment companies, savings banks, foundations, and all other stockholders not elsewhere classified.

* Domestic individuals are defined as (1) all resident and nonresident U.S. citizens (including A.P.O. members) and (2) all aliens residing either in the U.S. or in U.S. territories or possessions. Canal Zone, Puerto Rico, Virgin Islands, Guam, American Samoa, Wake and Midway Islands are U.S. territories and possessions.

Please check the type of stock issue being reported

☑ COMMON ☒ PREFERRED

CONFIDENTIAL

FORM B

EXHIBIT B-2

Stockholders of Record Classifications

1980 SURVEY OF SHAREOWNERS

AMONG PARTICIPATING MEMBERS OF THE AMERICAN PETROLEUM INSTITUTE

Please fill out this form in accordance with instructions on the back. Be sure to use a separate Form B for each common and preferred stock issue outstanding.

STOCKHOLDERS OF RECORD AND SHAREHOLDINGS BY MAJOR CLASSIFICATIONS

Date of Record: August 1980

Closing Price per Share on May 30, 1975: $

	LINE NO.	NUMBER OF HOLDERS OF RECORD	NUMBER OF SHARES HELD
TOTAL STOCKHOLDERS OF RECORD •	(01)	2,118,075	
FOREIGN STOCKHOLDERS	(02)	19,183	
TOTAL DOMESTIC STOCKHOLDERS •	(03)	2,098,892	
Breakdown of Domestic Stockholders			
INDIVIDUALS—Males & Females Combined •	(04)	1,457,337	
MAJOR: Males (If Readily Available) •	(04M)	643,913	
MAJOR: Females (If Readily Available)	(04F)	813,424	
MAJOR: JOINT ACCOUNTS •	(05)	387,754	
MAJOR: FIDUCIARY INDIVIDUALS •	(06)	151,273	
MAJOR: ALL OTHER—Sum of Lines (08) through (11)	(07)	102,538	
MINOR: Fiduciary Institutions •	(08)	34,964	
MINOR: Stock Brokers & Securities Dealers •	(09)	1,257	
MINOR: Nominees •	(10)	17,303	
MINOR: Institutions & Miscellaneous •	(11)	49,014	

Six largest oil companies
Name of Company

Name of Reporting Officer

Address

Title

Title or Designation of Stock Issue

Date

SPECIAL INSTRUCTIONS

REPORTING PROCEDURES

Please report the number of STOCKHOLDERS OF RECORD and the number of SHARES HELD for as many of the stockholder categories shown on the reverse side of this form as your company can conveniently provide.

If your company cannot furnish a complete Form B breakdown, please report the requested data for at least Lines (01), (02), and (03); and—if at all possible—Lines (04), (05), (06), and (07), which are included in the MAJOR BREAKDOWN.

Form B data may be based on closest available record date to June 30, 1980.

Completed Form B should be forwarded to the stock exchange or other requesting organization as soon as possible, but not later than August 20, 1980.

DEFINITIONS

Line (02) – FOREIGN STOCKHOLDERS are defined as all aliens residing outside the U.S., its territories and possessions. (For Canadian and other foreign companies, U.S. citizens should be reported as "domestic" stockholders of record.)

Line (03) – TOTAL DOMESTIC STOCKHOLDERS include individuals,* institutions and all other nonindividuals not classified as foriegn stockholders.

MAJOR BREAKDOWN OF DOMESTIC STOCKHOLDERS

Line (04) – INDIVIDUALS are non-fiduciary males and females. Do not include joint accounts [Line (05)], persons acting as custodian for minors under "Gifts to Minors" statutes [Line (06)], or fiduciary individuals and fiduciary joint accounts [Line (06)].

Line (05) – JOINT ACCOUNTS are two or more individuals, such as joint tenancy, tenancy in common, tenancy by the entirety and similar accounts.

Line (06) – FIDUCIARY INDIVIDUALS (including FIDUCIARY JOINT ACCOUNTS) are:

1. Guardians for individuals, life tenancies, pledgees, conservators, receiverships, committees for individuals, unincorporated estates, executors and administrators of estates.
2. Trustees – whether or not the beneficiaries of such accounts are individuals, institutions, or unknown.
3. Individuals acting as custodian for minors.

Fiduciary joint accounts involving an individual and an institution should be reported on Line (06) when the individual is named first in the joint registration. Where it is impossible to determine whether the fiduciary is an individual or institution, include on Line (08).

MINOR BREAKDOWN OF DOMESTIC STOCKHOLDERS
(Breakdown of Line (07))

Line (08) – FIDUCIARY INSTITUTIONS include banks, incorporated individuals, and other non-individuals constituting a fiduciary as defined in Line (06).

Line (09) – STOCKBROKERS AND SECURITIES DEALERS are persons or organizations, except banks, registered under Federal and State laws for the purpose of purchasing and selling securities for their own account or for the account of others.

Line (10) – NOMINEES are partnerships, individuals and organizations other than stock brokers which you believe are acting as stockholders of record in behalf of other beneficial owners.

Line (11) – INSTITUTIONS & MISCELLANEOUS include colleges and universities, personal holding corporations, financial institutions such as life insurance companies, investment companies, savings banks, foundations, and all other stockholders not elsewhere classified.

---

* Domestic individuals are defined as (1) all resident and nonresident U.S. citizens (including A.P.O. numbers) and (2) all aliens residing either in the U.S. or in U.S. territories or possessions. Canal Zone, Puerto Rico, Virgin Islands, Guam, American Samoa, Wake and Midway Islands are U.S. territories and possessions.

N.Y. STOCK
EXCHANGE

EXHIBIT C

LETTER TO SHAREOWNERS REFUSING TELEPHONE INTERVIEW AND THOSE WHOSE PHONE NUMBERS COULD NOT BE LOCATED

Stan West
Vice President
Business Research Division
212-623-5220

April 27, 1981

Ms. A. Shareowner
Madera Ave.
Oakland, CA 94619

Dear :

Please accept the enclosed one-dollar bill as a token of our sincerity and appreciation for taking a few minutes to complete and return the enclosed questionnaire as soon as possible.

The New York Stock Exchange is conducting this important nationwide survey among a scientifically-selected cross-section of people such as yourself. We conduct such studies from time to time to gather information that will help the Exchange, its listed companies and member brokers better serve current and potential investors. This study on energy matters and investments will have an important effect on business planning in the 1980's.

In answering the questions, feel free to consult with other adults in your home, but please be sure that your responses reflect your own attitudes and characteristics. Your efforts to reply to the questionnaire carefully and thoughtfully will be most appreciated. We have found that questionnaires sent by mail are a very effective way to assure accurate answers. When filling out this questionnaire, you have time to really think things over, and time to check your records before answering.

Please be assured you will not be asked to buy anything and your answers to all questions will, of course, be held in confidence. Only aggregate tabulations of individual responses will be made for research purposes. If you have any problems or questions, you may telephone the New York Stock Exchange collect at (212) 269-2190/91 between 9:00 a.m. and 2:00 p.m. on weekdays.

Sincerely yours,

Stan West

Enclosure

New York Stock Exchange, Inc.
Eleven Wall Street
New York, New York 10005

EXHIBIT C

1981 MAJOR PLANNING STUDY

Confidential Questionnaire

N.Y. STOCK
EXCHANGE

1a. Do you or anyone else in your household, including minors at home or away, now own any shares of common or preferred stock in any public corporations — that is, shares of stock that are publicly-traded either on an exchange or over-the-counter, or sold in the form of stock mutual funds by investment companies? Please include all holdings any household members may have in employee stock purchase plans

☐ Yes, own

☐ No, do not own
(Please continue with Question 2 and 3a, then Skip to Question 9)

b. (If "Yes" to Question 1a) Do you, yourself, now own any such shares?

☐ Yes, I own
(Please skip to Question 1d)

☐ No, I do not own
(IF YOU, YOURSELF, DO NOT OWN ANY SUCH SHARES, PLEASE HAVE AN ADULT IN YOUR HOUSEHOLD WHO OWNS STOCK FILL OUT THE REMAINDER OF THIS QUESTIONNAIRE STARTING AT QUESTION 1c)

c. Are you a different respondent from the person who answered Questions 1a and 1b?

☐ Yes, the person who filled out Questions 1a and 1b has asked me to continue filling out this part of the questionnaire. I qualify as a shareowner, according to the definition described in Question 1a.

☐ No, I am the same person who answered Questions 1a and 1b and will continue to fill out this questionnaire because no shareowner is available.

d. In what year did you first acquire any type of stock or mutual fund shares?

☐ Before 1970

☐ 1970 - 1974

☐ 1975 - 1980

☐ 1981

2. Please indicate the extent of your agreement or disagreement with each of the brief statements below by checking one of the spaces to the right.

	Agree Strongly	Agree to Some Extent	Disagree to Some Extent	Disagree Strongly	Don't Know
The energy shortage is artificial	☐	☐	☐	☐	☐
The cabinet Department of Energy should be abolished.	☐	☐	☐	☐	☐
Synthetic fuels development should be left entirely to the private economy.	☐	☐	☐	☐	☐
The government should limit the quantity of oil imported into this country.	☐	☐	☐	☐	☐
More exploration for oil and natural gas should be permitted on public lands.	☐	☐	☐	☐	☐
Price controls on natural gas should be eliminated immediately.	☐	☐	☐	☐	☐
Oil companies earn exorbitant profits.	☐	☐	☐	☐	☐
Oil companies are responsible for high gasoline and fuel oil prices.	☐	☐	☐	☐	☐
The so-called "windfall profits tax" on domestic oil should be repealed.	☐	☐	☐	☐	☐
To increase U.S. energy production environmental regulations should be relaxed somewhat.	☐	☐	☐	☐	☐

3a. Do you currently have or invest in any of the following? (Check all that apply)

( ) Listed common stock
( ) Stock mutual funds
( ) Unlisted common stock
( ) Preferred stock
( ) Employer or Union pension fund
( ) State or municipal retirement fund
( ) IRA/Keogh Plan
( ) Common trust fund (bank)
( ) Income from an estate or trust
( ) Annuities
( ) Long-term U.S. bonds
( ) Municipal bonds
( ) Convertible securities
( ) U.S. Treasury bills
( ) Corporate bonds
( ) Tax-free mutual funds
( ) Tax Shelters
( ) Money market mutual funds
( ) Options
( ) Warrants
( ) Commodity contracts
( ) Life insurance on yourself
( ) Insurance coverage on real or personal property
( ) Passbook savings account
( ) Mutual savings bank (depositor)
( ) Own home
( ) Real estate other than home
( ) U.S. savings bonds
( ) Employee savings plan
( ) Employee profit-sharing plan
( ) Savings certificates
( ) Negotiable certificates of deposit
( ) Ownership in a private company
( ) Tangible investments (gold, silver, gems, art, coins, etc.)

NON-SHAREOWNERS, PLEASE SKIP TO QUESTION 9;
SHAREOWNERS, PLEASE CONTINUE WITH QUESTION 3b.

3b. If you are a shareowner in any public oil corporation, please check each of the oil companies listed below in which you currently own any shares of common or preferred stock; shareowners who do not own oil company shares, please check either of last two choices.

Yes, own ( ) Ashland Oil, Inc.
( ) Atlantic Richfield Company
( ) Cities Service Company
( ) Conoco Inc.
( ) Exxon Corporation
( ) Gulf Oil Corporation
( ) Mobil Corporation
( ) Occidental Petroleum Corporation
( ) Phillips Petroleum Company
( ) Standard Oil Co. of California
( ) Standard Oil Co. (Indiana)
( ) Standard Oil Co. (Ohio)
( ) Sun Company, Inc.
( ) Tenneco Inc.
( ) Texaco Inc.
( ) Union Oil Co. of California
( ) None of above, but own some other oil company stock

No, ( ) DON'T OWN ANY OIL COMPANY STOCK NOW, but previously owned.
( ) NEVER owned any oil company stock (please skip to Question 6a).

4a. If you own any oil company stock, do you own your oil company shares alone (singly) or jointly (with someone else)?

( ) Singly ( ) Jointly ( ) Both

b. Are your oil company shares registered in your own name or in a broker's name, that is, in street name as in a margin account?

( ) Registered in my name
( ) Registered in broker's name (street name)
( ) Some shares registered in my name, others in broker's name

c. Throughout your investment experience, you may have obtained stock or mutual fund shares through various means. Have you ever obtained shares through any of the means listed below? (Check as many as apply in column 3c. Then answer Question 3d).

d. (For items you checked in Question 3c) which one of the following was the first means through which you obtained stock or mutual fund shares? (Check only one means below for Question 3d).

Possible Means of Obtaining Stock	"Ever Obtained" Question 3c	"First Means" Question 3d
Through a bank	( )	( )
Through a stockbroker or dealer	( )	( )
Through an employee stock purchase plan	( )	( )
Through an insurance agent	( )	( )
As a bonus from the company you worked for	( )	( )
As a gift or inheritance	( )	( )
Through a stock split or stock dividend	( )	
Some other way (please specify) ______	( )	( )

5a. Does anyone else in your household, including minors at home or away, now own any oil company common or preferred stock — either singly or jointly with someone else (include any held for them by a custodian)?

( ) Yes ( ) No (Skip to Question 6a)

b. If "yes" to 4a, how many adult shareowners (age 21 or over) of oil company stocks are in your household, other than yourself?

____ Adult owners ( ) None

c. If "yes" to 4a, how many minor (under age 21) shareowners of oil company stocks are in your household?

____ Minor owners ( ) None

6a. How would you characterize your overall stock market activity (in dollars) since January, 1975? (Include all stock activity, not just oil stock.)

( ) Bought more stock than sold
( ) Sold more stock than bought
( ) Bought and sold about equally
( ) No activity, just kept same position

b. If you sold more stock than you bought since January 1975, what action did you take with the proceeds of the stock?

( ) Invested outside the stock market
( ) Used for day-to-day expenses
( ) Spent otherwise

c. How would you characterize your stock market activity since the most recent reduction in the capital gains tax, which took effect in early 1979, have you . . .

( ) Bought more stock than sold
( ) Sold more stock than bought
( ) Bought and sold about equally
( ) No activity, just kept same position

7a. Considering the total current market value of all your investments except your home and personal possessions, about what percentage is in any kind of common and preferred stock?

____ %

b. What is the range of the approximate current market value of your total investment in all types of common and preferred stock?

( ) Less than $10,000
( ) $10,000 to $24,999
( ) $25,000 to $49,999
( ) $50,000 to $99,999
( ) $100,000 and Over

c. Of this approximate current market value of your total common and preferred stocks, about what percentage is in oil company stocks?

____ %

8a. Do you participate in one or more dividend reinvestment plans of companies whose common or preferred stock you own?

( ) Yes ( ) No (Skip to Question 8c)

b. If "yes" to 8a above, in how many companies' dividend reinvestment plans do you participate?

____ company plans

c. Excluding company reinvestment plans, if you receive cash dividends directly from any of your stockholdings, what percent of each dividend dollar is reinvested in stock, what percent is saved and what percent is spent for day-to-day living expenses on purchases such as a TV, automobile or vacation?

____ % reinvested in stock
____ % saved in some other form
____ % spent
100 % of dividend dollars

CLASSIFICATION DATA — necessary for purposes of analysis. Your personal data are added to those of similar people; only totals are used.

9. What is your approximate age?

( ) Under 21
( ) 21 — 24
( ) 25 — 34
( ) 35 — 44
( ) 45 — 54
( ) 55 — 64
( ) 65 — 74
( ) 75 or Over

10. What was the last grade of school you completed?

( ) Some elementary
( ) Completed elementary school
( ) Some high school
( ) Completed high school
( ) Some college
( ) Business or technical school
( ) Completed college
( ) Graduate study

11. In which category does the total income of your household for 1980 fall?

( ) Under $5,000
( ) $ 5,000-$ 9,999
( ) $10,000-$14,999
( ) $15,000-$19,999
( ) $20,000-$24,999
( ) $25,000-$34,999
( ) $35,000-$49,999
( ) $50,000-$99,999
( ) $100,000 and over

12a. What is your . . .

OCCUPATION: ______________________________

JOB TITLE: ______________________________

NONE: ________

b. If "none," are you . . .

( ) Retired
( ) A student
( ) A housewife
( ) Other (Specify): ______________________________

13. Are you . . .

( ) Married
( ) Single
( ) Separated
( ) Widowed
( ) Divorced

14. Are you . . .

( ) Male head of household
( ) Other male
( ) Female head of household
( ) Other female

____
(Your Name, please)

THANK YOU

Study No. 2118

N.Y. STOCK EXCHANGE

EXHIBIT D

LETTER TO TELEPHONE RESPONDENTS
WHO AGREED TO COMPLETE MAIL
QUESTIONNAIRES

Stan West
Vice President
Business Research Division
212-623-5220

April 27, 1981

Ms. A. Shareowner
Madera Ave.
Oakland, CA 94619

Dear :

Thank you for agreeing to participate in this important nationwide study of attitudes toward energy matters and investments. Please accept the enclosed one-dollar bill as a token of our sincerity and appreciation for taking a few minutes to complete and return the enclosed questionnaire as soon as possible.

The New York Stock Exchange is conducting this nationwide survey among a scientifically-selected cross-section of people such as yourself. We conduct such studies from time to time to gather information that will help the Exchange, its listed companies and member brokers better serve current and potential investors. This study on energy matters and investments will have an important effect on business planning in the 1980's.

In answering the questions, feel free to consult with other adults in your home, but please be sure that your responses reflect your own attitudes and characteristics. Your efforts to reply to the questionnaire carefully and thoughtfully will be most appreciated. We have found that questionnaires sent by mail are a very effective way to assure accurate answers. When filling out this questionnaire, you have time to really think things over, and time to check your records before answering.

Please be assured you will not be asked to buy anything and your answers to all questions will, of course, be held in confidence. Only aggregate tabulations of individual responses will be made for research purposes. If you have any problems or questions, you may telephone the New York Stock Exchange collect at (212) 269-2190/91 between 9:00 a.m. and 2:00 p.m. on weekdays.

Sincerely yours,

Stan West

Enclosure

New York Stock Exchange, Inc.
Eleven Wall Street
New York, New York 10005

EXHIBIT D

1981 MAJOR PLANNING STUDY

Confidential Questionnaire

N.Y. STOCK
EXCHANGE

1. You recently completed a telephone interview with a representative of Brehl & Associates. During that interview, you indicated your ownership of stock in one or more public oil corporations. Do you still own some oil company stock?

☐ Yes ☐ No

IF YES, PLEASE PROCEED TO QUESTION 2. EVEN IF YOU HAVE RECENTLY DISPOSED OF YOUR OIL STOCK, PLEASE ANSWER ALL QUESTIONS (STARTING WITH QUESTION 2) DEALING WITH OIL COMPANY STOCK AS THOUGH YOU STILL OWNED IT.

2. Please check each of the oil companies listed below in which you currently own any shares of common or preferred stock:

☐ Ashland Oil, Inc.
☐ Atlantic Richfield Company
☐ Cities Service Company
☐ Conoco, Inc.
☐ Exxon Corporation
☐ Gulf Oil Corporation
☐ Mobil Corporation
☐ Occidental Petroleum Corporation
☐ Phillips Petroleum Company
☐ Standard Oil Company of California
☐ Standard Oil Company (Indiana)
☐ Standard Oil Company (Ohio)
☐ Sun Company
☐ Tenneco Inc.
☐ Texaco Inc.
☐ Union Oil Company of California

3a. Throughout your investment experience, you may have obtained stock or mutual fund shares through various means. Have you ever obtained shares through any of the means listed below? (Check as many as apply in column 3a. Then answer Question 3b).

b. (For items you checked in Question 3a) Which one of the following was the first means through which you obtained stock or mutual fund shares? (Check only one means below for Question 3b).

Possible Means of Obtaining Stock	"Ever Obtained" Question 3a	"First Means" Question 3b
Through a bank	☐	☐
Through a stockbroker or dealer	☐	☐
Through an employee stock purchase plan	☐	☐
Through an insurance agent	☐	☐
As a bonus from the company you worked for	☐	☐
As a gift or inheritance	☐	☐
Through a stock split or stock dividend	☐	

c. In what year did you first acquire any type of stock or mutual fund shares?

☐ Before 1970
☐ 1970 — 1974
☐ 1975 — 1980
☐ 1981

4. Do you currently have or invest in any of the following? (Check all that apply)

- ☐ Listed common stock
- ☐ Stock mutual funds
- ☐ Unlisted common stock
- ☐ Preferred stock
- ☐ Employer or union pension fund
- ☐ State or municipal retirement fund
- ☐ IRA/Keogh Plan
- ☐ Common trust fund (bank)
- ☐ Income from an estate or trust
- ☐ Annuities
- ☐ Long-term U.S. bonds
- ☐ Municipal bonds
- ☐ Convertible securities
- ☐ U.S. Treasury bills
- ☐ Corporate bonds
- ☐ Tax-free mutual funds
- ☐ Tax shelters
- ☐ Money market mutual funds
- ☐ Options
- ☐ Warrants
- ☐ Commodity contracts
- ☐ Life insurance on yourself
- ☐ Insurance coverage on real or personal property
- ☐ Passbook savings account
- ☐ Mutual savings bank (depositor)
- ☐ Own home
- ☐ Real estate other than home
- ☐ U.S. savings bonds
- ☐ Employee savings plan
- ☐ Employee profit-sharing plan
- ☐ Savings certificates
- ☐ Negotiable certificates of deposit
- ☐ Ownership in a private company
- ☐ Tangible investments (gold, silver, gems, art, coins, etc.)

5a. How would you characterize your overall stock market activity (in dollars) since January 1975?

- ☐ Bought more stock than sold
- ☐ Sold more stock than bought
- ☐ Bought and sold about equally
- ☐ No activity, just kept same position

b. If you sold more stock than you bought since January 1975, what action did you take with the proceeds of the stock?

- ☐ Invested outside the stock market
- ☐ Used for day-to-day expenses
- ☐ Spent otherwise

c. How would you characterize your stock market activity since the most recent reduction in the capital gains tax, which took effect in early 1979, have you . . . .

- ☐ Bought more stock than sold
- ☐ Sold more stock than bought
- ☐ Bought and sold about equally
- ☐ No activity, just kept same position

6a. Do you participate in one or more dividend reinvestment plans of companies whose common or preferred stock you own?

☐ Yes ☐ No (Skip to Question 6c)

b. (If "Yes" to 6a above) In how many companies' dividend reinvestment plans do you participate?

_____ company plans

c. Excluding company reinvestment plans, if you receive cash dividends directly from any of your stockholdings, what percent of each dividend dollar is reinvested in stock, what percent is saved and what percent is spent for day-to-day living expenses on purchases such as a TV, automobile or vacation?

____% reinvested in stock
____% saved in some other form
____% spent
100 % of dividend dollars

CLASSIFICATION DATA — necessary for purposes of analysis. Your personal data are added to those of similar people; only totals are used.

7. What is your approximate age?

- ☐ Under 21
- ☐ 21 – 24
- ☐ 25 – 34
- ☐ 35 – 44
- ☐ 45 – 54
- ☐ 55 – 64
- ☐ 65 – 74
- ☐ 75 or Over

8. What was the last grade of school you completed?

- ☐ Some elementary
- ☐ Completed elementary school
- ☐ Some high school
- ☐ Completed high school
- ☐ Some college
- ☐ Business or technical school
- ☐ Completed college
- ☐ Graduate study

9. In which category does the total income of your household for 1980 fall?

- ☐ Under $5,000
- ☐ $ 5,000-$ 9,999
- ☐ $10,000-$14,999
- ☐ $15,000-$19,999
- ☐ $20,000-$24,999
- ☐ $25,000-$34,999
- ☐ $35,000-$49,999
- ☐ $50,000-$99,999
- ☐ $100,000 and Over

10. Are you . . .

- ☐ Married
- ☐ Single
- ☐ Separated
- ☐ Widowed
- ☐ Divorced

11. Are you . . .

- ☐ Male head of household
- ☐ Other male
- ☐ Female head of household
- ☐ Other female

I am the person who answered the telephone interview.

Please sign: (Mr.) (Ms.) ______________________

Print Name ______________________

Address ______________________

Zip Code ____________

Study No. 0999

REPORT ON
INDIRECT SHAREOWNERSHIP
IN
SIXTEEN U.S. OIL COMPANIES

VOLUME II

Conducted
for
The American Petroleum Institute
by
The New York Stock Exchange, Inc.

June, 1981

CONTENTS

VOLUME II

Page

-- Introduction 1
-- Participating Oil Companies 3
-- Summary of Findings 4

INDIRECT SHAREOWNERSHIP

-- Unduplication of Indirect Shareowner Estimates 5
-- Explanatory Notes on Unduplication of Indirect Shareowner Estimates 7
-- Estimate of Stock Mutual Fund Shareowners 9
-- Estimate of Closed-End Company Shareowners 10
-- Estimate of Life Insurance Company Participating Policyholders 11
-- Estimate of Stock Life and Property/Casualty Insurance Company Stockholders 13
-- Estimate of Private Pension Fund Participants and Annuitants 14
-- Estimate of State/Local Pension Fund Participants and Annuitants 16
-- Estimate of Common Trust Fund Beneficiaries 18
-- Estimate of College Endowment Fund Beneficiaries 20

TABULATIONS FOR SIXTEEN COMPANY SAMPLE

INTRODUCTION

This study estimates the number of adults in the U.S. population who, as of year-end 1980, were indirect shareowners of one or more of 16 API member oil companies participating in this study. While some figures used in this report derive from data as of year-end 1979, which were the latest available, any growth in those categories during the following year would add only minimally to the overall count. Therefore, the time frame referred to in this report is year-end 1980, although the estimates given for a few categories were based on year-end 1979 data.

Indirect shareowners are defined as those individuals who have a stake in or benefit in some way from an institution's investment in common stock, irrespective of the size of that investment. This contrasts with people who own shares directly in a public corporation.1/

Indirect ownership of the 16 oil stocks was estimated through eight institutional categories. Each category was thoroughly researched, the availability and reliability of data determined, and the optimal estimating procedure chosen. These estimates were then reduced for duplication with direct ownership and among each other. Full descriptions of all procedures used comprise the body of this report.

Scope and Limitations of Study

In the final analysis, any estimate of indirect shareownership is necessarily a "best effort" attempt to quantify disparate groups of individuals. Thus, while most important institutional categories have been included here, the estimate cannot be considered a definitive final account of all individual indirect shareowners of the 16 oil companies. The very nature of the subject and incompleteness of information render precision impossible. Indeed, certain institutional categories which would have added some, if not large numbers of, individuals to the final estimate -- such as mutual savings banks, individual trustee accounts, deferred profit-sharing and thrift plans -- were not included, due to lack of essential information. Nevertheless, every reasonable effort was made to secure data and estimate accurately using prudent, conservative and statistically acceptable procedures. The estimate can be taken, therefore, as a good general indicator of the magnitude of importance the oil industry has among the U.S. adult population.

1/ The NYSE Shareownership 1980 survey includes stock mutual fund owners in its count of direct shareowners, because these funds invest in stock by definition. On the other hand, this study, which only counts individuals who own specific issues through stock mutual funds, necessarily treats the category as a vehicle for indirect shareownership.

Information about the demographic makeup of union pension fund participants was as impossible to find as the very basic data concerning underlying stockholdings of this category. Although several unions were contacted, none had gathered any demographic information about their members. In addition, determining the extent of union ownership of the 16 oil stocks met with the same difficulties encountered for the entire private pension category. These difficulties are described in the section estimating private pension fund indirect owners. However, some limited information is known. United Steel workers indirectly own oil company stock through Bethlehem Steel and U.S. Steel & Carnegie pension funds. Moreover, the likelihood that most union pension funds invest in one or more of the 16 oil stocks is great, because an extremely large proportion of private pension funds invest in oil stock, in general.

Comparability of Findings

This estimate of indirect shareownership of one or more of the 16 oil stocks can serve as a benchmark for future studies. Estimating procedures and sources used have been carefully detailed and documented, so that all or any part of this analysis may be repeated and updated.

Results of this study are not comparable, however, to those of the 1975 Toltec study of Indirect Shareownership of the Six Largest Oil Companies. Beyond the most obvious difference, arising from the variation in the number of oil companies studied, are conceptual differences in the definition of indirect shareowners. The current study counts all individuals who own oil stock indirectly through their participation in institutional investments, regardless of the size of those investments. In contrast, the 1975 estimate attempted to eliminate indirect shareowners owning less than one share. Furthermore, radical differences in the ultimate estimates occur because the current study includes and uncovers a huge number of indirect shareowners through participating life insurance, a group which was not addressed in 1975.

Nevertheless, in spite of these critical differences, every attempt was made to update the 1975 estimate on its own terms. The effort was finally abandoned, however, because: 1) certain sources used in 1975 were no longer available, and 2) the 1975 study did not fully detail methodologies, sources and assumptions, so that small but consequential steps in the estimating process could not be repeated.

SIXTEEN OIL COMPANIES PARTICIPATING IN THE STUDY

Ashland Oil, Inc.

Atlantic Richfield Company

Cities Service Co.

Conoco Inc.

Exxon Corporation

Gulf Oil Corp.

Mobil Corporation

Occidental Petroleum Corporation

Phillips Petroleum Co.

Standard Oil Co. of California

Standard Oil Co. (Indiana)

Standard Oil Co. (Ohio)

Sun Company, Inc.

Tenneco Inc.

Texaco Inc.

Union Oil Co. of California

SUMMARY OF FINDINGS

As of year-end 1980, over 80 million adults were indirect owners of one or more of the 16 participating API member oil companies. This means that about half the U.S. adult population have a stake in the oil industry -- whether they are aware of it or not.

UNDUPLICATION OF INDIRECT SHAREOWNER ESTIMATES

Estimates of indirect owners of the 16 oil stocks were developed in eight institutional categories, as detailed in the next section. Arriving at a final estimated total of indirect owners of the oil stocks required eliminating duplication with direct owners and among the various categories. Specifically, direct owners were removed from the institutional groups in which they also participate. Intercategory unduplication was achieved by taking each estimated indirect shareowner category in sequence and systematically removing individuals in one category who could logically be expected to be in the preceding one. The resulting unduplicated category counts could vary, therefore, if the order of unduplication had been different. The sum total, however, would remain constant. The summary table below compares raw and unduplicated indirect shareowner category estimates, followed by a diagram showing the steps in the unduplication process. Explanatory notes on the unduplication procedure begin on Page 7.

Raw and Unduplicated Estimates of Indirect Owners of Oil Stock through Eight Investment Categories

Indirect Shareowner Categories	Estimates: Raw	Estimates: Unduplicated
Stock Mutual Funds *Shareowners*	4,030,000	3,328,000
Closed-End Companies *Shareowners*	306,000	202,000
Life Insurance Companies *Participating Policyholders*	51,101,000	48,482,000
Stock Life and Property Insurance Companies *Stockholders*	911,000	351,000
Private Pension Funds *Participants & Annuitants*	32,800,000	23,084,000
State and Local Pension Funds *Participants & Annuitants*	1,774,000	1,149,000
Common Trust Funds *Beneficiaries*	241,000	44,000
College Endowment Funds *Beneficiaries*	5,809,000	5,809,000
Total:	96,972,000	82,449,000

UNDUPLICATION OF ESTIMATED INDIRECT OWNERS OF OIL STOCK THROUGH EIGHT INVESTMENT CATEGORIES*

(Thousands)

	Stock Mutual Funds	Closed-End Investment Companies	Life Insurance Companies	Stock Insurance Companies	Private Pension Funds	State and Local Pension Funds	Common Trust Funds	College Endowment Funds	Total
Estimated Indirect Shareowners	4,030	306	51,101	911[4]	32,800	1,774	241	5,809	96,972
Remove Duplication With: Direct Owners	-702[1]	-100[2] 206	-1,680[1] 49,421	-532[5] 379	-432[1] 32,368	-162[1] 1,612	-168[1] 73		
Indirect Owners: Stock Mutual Funds		-4[3]	-939[3]	-2[3] 377	-615[3] 31,753	-31[3] 1,581	-1[3] 72		
Life Insurance Companies				-26[6]	-8,669[6]	-432[6]	-20[6] 52		
Private Pension Funds							-7[7] 45		
State and Local Pension Funds							-1[8]		
Unduplicated Indirect Shareowners	3,328	202[9]	48,482	351[9]	23,084[10]	1,149	44	5,809[11]	82,449

---

* Explanatory notes keyed to italicized raised footnote numbers appear on pages 7 and 8.

EXPLANATORY NOTES ON UNDUPLICATION OF INDIRECT SHAREOWNER ESTIMATES

1. Direct owners of oil stocks were removed from all indirect shareowner categories. The proportions of direct owners owning or participating in other investment vehicles (except closed-end companies) were established in the NYSE direct owner survey as follows:

Direct Owners of Oil Company Stock

Also Have:	Total (3,041,000)
Stock Mutual Funds	23%
Life Insurance	56
Property/Casualty Insurance	67
Private Pension Funds	14
State & Local Pension Funds	5
Common Trust Funds	6

2. In the absence of hard data, the proportion of direct owners investing in mutual funds was assumed to be the same for closed-end funds, which are similar in character and purpose. However, since closed-end funds are far less prevalent than mutuals -- about 1 to 7 -- the chances direct owners could own them is greatly reduced and was adjusted accordingly (23% x 1/7 = 3.3% x 3.0 million direct owners).

3. In the absence of actual data, indirect owners of oil stock through mutual funds were removed from subsequent categories by a factor equal to their incidence in the adult population (3.3 million indirect owners through mutual funds ÷ 176.1 million 1980 adult population* = 1.9%).

4. Since the estimate of life and property/casualty company indirect shareowners could not be projected to the universe, and was based on a segment of companies representing 25% of total assets, all duplication factors applied to this category were reduced by 75%.

5. The number of direct owners of oil stocks having life and property/casualty insurance was determined by separating NYSE direct owner survey factors for all life and all property/casualty insurance companies by assets, assuming the degree of duplicate ownership of both types of stock insurance, and recombining. According to ratios shown in Best's Agents Guide, of the 56% direct owners who have life insurance, 22% would have stock type, and 34%, mutual. Of 67% having property/casualty insurance, 52% would have stock type, and 15% mutual. The unduplicated proportion of direct owners who have stock life and property/casualty insurance is estimated as follows:

At least 52% are known to own one type of stock insurance and a fifth of those owning the second type are assumed also to own the first. Therefore, 70% of direct owners of oil stock have life and property/casualty insurance (52% + [80% x 22%] = 70% x 3.0 million direct owners).

6. In the absence of actual data, indirect owners of oil stock through life insurance companies were removed from subsequent categories by a factor equal to their incidence in the adult population (48.1 million direct owners through life insurance companies ÷ 176.1 million 1980 adult population* = 27.3%).

7. In the absence of actual data, indirect owners of oil stock through private pension funds (which were estimated as of year-end 1979) were removed from the common trust fund category by a factor equal to their incidence in the adult population (22.8 million indirect owners through private pension funds ÷ 174.2 million 1979 adult population* = 13.1%).

8. In the absence of actual data, indirect owners of oil stocks through state and local pension funds (which were estimated as of year-end 1979) were removed from the common trust category by a factor equalling their incidence in the adult population (1.1 million indirect owners through private pension funds ÷ 174.2 million 1979 adult population* = 1%).

9. Indirect owners of oil stock through closed-end investment companies and stock insurance companies were not removed from subsequent categories, because their incidence in the adult population is insignificant (less than .5%).

10. Indirect owners of oil stock through private pension funds were not removed from public pension funds, because the data on which the estimates of the two categories were based were mutually exclusive.

11. The raw count of beneficiaries through college endowment funds was not reduced. Duplication between student beneficiaries (generally between 18-21 years old) through college endowment funds and other investment categories was assumed to be insignificant. Most stocks and mutual funds bought as a "gift to minors" have probably been sold off to finance college education; young people who have not yet established families generally do not have life insurance; and little pension coverage is likely for most of these individuals who are not employed.

---

* Population estimates derive from the Statistical Abstract of the U.S. 1980 U.S. Department of Commerce, Bureau of the Census, and Population Estimates and Projections, Current Population Reports, U.S. Department of Commerce, Bureau of the Census, Series P-25, No. 899, May 1981.

ESTIMATE OF STOCK MUTUAL FUND SHAREOWNERS: 4,030,000

Indirect owners for this category were estimated by projecting the proportion of total assets represented by stock mutual funds investing in oil stocks -- which necessarily relates to the number of investors -- to the known universe of individuals owning such funds as of mid-year 1980. According to the NYSE 1980 Shareownership study, 4,915,000 individuals owned shares in stock mutual funds.1/ This procedure was chosen over one based on stockholder-of-record accounts for which no reliable method for converting to unduplicated individuals could be found.

Vickers Guide to Investment Company Portfolios and Spectrum 2 were used to determine the degree of indirect shareownership of oil stocks through stock mutual funds.2/ The two sources reported on 717 of the 907 active mutual funds registered with the SEC as of fall 1980.3/ For this analysis, however, funds which did not invest in common stock were removed, reducing the sample of 457 and the universe total to 617. The distribution of sampled funds appeared broadly representative of the universe. However, analysis by asset size revealed a concentration of 87% of total assets, clearly indicating over-representation of larger funds. An examination of the sample portfolios showed that 64% of the funds, representing 75% of total assets, invested in one or more of the 16 oil stocks.

Estimating the extent to which all stock mutual funds own oil stock required making two assumptions about the 160 unsampled funds. First, the funds were assumed to invest in oil stocks to a lesser extent than the sampled funds. Half of the sampled funds with less than $20,000,000 assets were known to hold oil stocks. However, since the unsampled funds also contained some larger funds, this proportion was arbitrarily increased to 55%. In the absence of actual data, this 55% was also assumed to represent assets. The percent of assets contributed by the unsampled funds owning oil stocks was then calculated by multiplying 55% by the percent of assets represented by the unsampled funds, 13%, yielding 7%.

To estimate the proportion of assets represented by all stock mutual funds investing in oil stock, the known and estimated proportions were combined (75% + 7%) yielding 82%. Finally, this was multiplied by the 4,915,000 individuals owning stock mutual funds, for an estimated total of 4,030,000 indirect shareowners of oil stock through stock mutual funds.

1/ Shareownership 1980, New York Stock Exchange, Inc., New York, N.Y., 1981, pg. 2.

2/ Vickers Guide to Investment Company Portfolios, Vickers Associates, Huntington, N.Y., November 1980.

Spectrum 2, Investment Company Portfolios, Computer Direction Advisors, Inc., Silver Spring, Md., December 1980.

3/ Classification, Assets and Location of Registered Investment Companies Under the Investment Company Act of 1940 as of September 30, 1980, Office of Applications and Reports Services, SEC, Washington, D.C.

ESTIMATE OF CLOSED-END COMPANY SHAREOWNERS: 306,000

Vickers directory of investment companies provided the basis for estimating indirect shareownership of oil stocks through closed-end companies.1/ Vickers reported on 82 of the 127 active companies registered with the SEC as of fall 1980.2/ For this analysis, however, companies which did not invest in common stock were removed reducing the sample to 44 and the universe total to 94. While the distribution of sampled companies by asset size was reasonably representative of the total population, it was skewed toward larger companies, accounting for 81% of universe assets.

A study of these portfolios showed that 57% of the companies invested in one or more of the 16 oil stocks. Investment company directories revealed that these companies had a total of 252,047 stockholders.3/

Estimating ownership of oil stock for the remaining unsampled funds depended on a number of assumptions. First, a smaller proportion of the unsampled funds were assumed to own oil stock than those sampled. If the sample were weighted by assets to reflect the universe, the proportion owning oil stocks falls to 51%. Furthermore, since smaller companies, which are less likely to own oil stock, heavily comprise the unsampled companies, the proportion was arbitrarily reduced to 45%. Multiplying this proportion by the number of unsampled companies (45% x 24) yields eleven additional companies owning oil stock.

In addition, since the number of stockholders of these companies is unknown, it was necessary to assign them a logical number of stockholders. Since the remaining companies are smaller in asset size than those sampled, the average number of stockholders of companies of less than $50,000,000 assets was computed (4,900) and applied (11 companies x 4,900 stockholders = 53,900 additional indirect stockholders). Combined with known indirect shareowners, this totals 306,000 indirect shareowners of oil stock through closed-end investment companies.

1/ Vickers Guide to Investment Company Portfolios, Vickers Associates, Huntington, N.Y., November 1980.

2/ Classification, Assets and Location of Registered Investment Companies Under the Investment Company Act of 1940 as of September 30, 1980, Office of Applications and Reports Services, SEC, Washington, D.C.

3/ Weisenberger Investment Companies Service, 1980 Edition, Warren, Gorham & Lamont, New York, N.Y.

Moody's Bank & Finance Manual, Vol. 2, Moody's Investor Service, New York, N.Y., 1980.

In cases where stockowner counts were not published, investment companies were assigned 500 stockholders each.

ESTIMATE OF LIFE INSURANCE COMPANY PARTICIPATING POLICYHOLDERS: 51,101,000

Vickers Guide to Insurance Company Portfolios 1/ provided stock and mutual life insurance company investment in the 16 oil companies as of fall 1980. The two types of life insurance companies were analyzed separately, since they are structured differently and have somewhat different investment characteristics. Vickers' samples represented 98% of all mutual company assets and 80% of stock company assets reported in Bests Agents Guide as of year-end 1979.2/ Since both samples over-represented highly-capitalized insurance companies, each was weighted by assets to ensure representativeness and projectability. On this basis, the Vickers' portfolios show that 65% of mutual life and 43% of stock life insurance companies own one or more of the 16 oil companies.

In the case of life insurance companies, participating policyholders are considered indirect owners of stock, because they are entitled to receive policy dividends which reflect investment performance. To estimate the number of indirect shareowners of oil stocks among the 144 million life insurance policyholders as of year-end 1979,3/ it was necessary to build upon a series of facts and make certain assumptions:

1. 49.8% of all life insurance was issued by mutual companies and 50.2% by life companies, as of year-end 1979.4/
2. Virtually all mutual companies issue participating life insurance, whereas stock companies generally issue non-participating.5/
3. Of all life insurance in force, 57% was participating as of year-end 1979.6/
4. Therefore, 49.8% of participating insurance must have been issued by mutual companies and the remaining 7.2% by stock companies.
5. In the absence of actual data, the percent of participating life insurance in force is assumed to represent the percent of participating policyholders.
6. Accordingly, the number of participating policyholders of mutual and stock insurance companies was determined by multiplying the total number of policyholders by the incidence of participating policyholders in each population (found in 4 and 5, above). This yielded 71,712,000 participating policyholders of mutual insurance companies and 10,368,000 participating policyholders of stock insurance companies.

7. Finally, to determine the number of participating policyholders who indirectly own shares of oil company stock, the proportion of companies owning oil stock, by assets, was multiplied by the number of participating policyholders of both mutual and stock insurance companies, as follows:

	71,712,000 participating policyholders of mutual companies x 65% mutual companies investing in oil stock = 46,612,800 participating policyholders of mutual companies.
Plus	10,368,000 participating policyholders of stock companies x 43% stock companies investing in oil stock = 4,458,200 participating policyholders of stock companies.
Yields	an estimated total of 51,101,000 indirect shareowners of one or more of the 16 oil stocks through life insurance companies.

1/ Vickers Guide to Insurance Company Portfolios, Vickers Associates, Huntington, N.Y., September 1980.

2/ "Ranking by Admitted Assets," Bests Agents Guide to Life Insurance Companies 1980, 7th Edition, A.M. Best Company, Inc., Oldwick, N.J. pp. xi-xxi.

Special tabulations, A.M. Best Company, Inc., Oldwick, N.J.

3/ 1980 Life Insurance Fact Book, American Council of Life Insurance, pg. 17.

Special Note: 1979 universe figures for policyholders, participating insurance in force, mutual insurance and stock insurance in force were used because they are the most recently available. However, the American Council of Life Insurance predicts that total policyholders will remain unchanged for 1980, and the other percentages will alter minimally.

4/ Ibid, pg. 21

5/ Ibid, pg. 21. This assertion was further confirmed through discussions with analysts at A.M. Best Company, Inc.

6/ Ibid, pg. 21

ESTIMATE OF STOCK LIFE AND PROPERTY/CASUALTY INSURANCE COMPANY STOCKHOLDERS: 911,000

Whereas only participating policyholders are the indirect owners of stock through life insurance companies, the stockholders of stock life and property/casualty insurance companies are counted as indirect shareowners of underlying securities. However, though the degree of oil stock investment by these companies was determinable, the number of people represented was not. Projecting to the universe was impossible for three reasons: many stock insurance companies are owned by large corporations not in the insurance business; others are owned by mutual insurance companies which have no stockholders; and stockholder data could not be found for numerous others. Nevertheless, the following best efforts were made to provide an additional -- if not complete -- segment of indirect owners of oil stock.

Vickers guide to insurance companies1/ showed the equity holdings of 738 stock insurance companies, representing 60% of total stock insurance agents.2/ These portfolios revealed that 399 companies invested in one or more of the 16 oil issues as of fall 1980. Of these companies, 71 were owned by non-insurance company corporations, 18 by mutual insurance companies, and stockholder records could not be found for 90.3/ This left 220 insurance companies whose stockholders could be identified, totaling 759,300.

However, since this number was derived from stockholder-of-record accounts, it was corrected to represent individual shareowners. NYSE experience in other studies shows that the average stockholder-of-record list must be expanded a net of 20% to both separate joint accounts and reduce multiple account individuals. Accordingly, the adjusted number of individual indirect shareowners of oil company stock through stock insurance companies was calculated to be (not less than) 911,000.

1/ Vickers Guide to Insurance Company Portfolios, Vickers Associates Huntington, N.Y., September 1980.

2/ Special Estimates, "Stock Insurance Companies Total Assets," A. M. Best Company, Inc., Oldwick, N.J., December 1979.

3/ A. M. Best Company, Inc. provided stockholder counts for many stock insurance companies, based on unpublished collected data.

Moody's Bank & Finance Manual, Vol. 2, 1980, Moody's Investor Service, Inc., New York, N.Y.

Standard & Poor's Register/1981, Vol. 1,3, Standard & Poor's Corporation, New York, N.Y.

ESTIMATE OF PRIVATE PENSION FUND PARTICIPANTS AND ANNUITANTS: 32,800,000

CAVEAT: Information about private pension funds and the securities they hold is scant and incomplete. While pension funds are required to file annually with the U.S. Department of Labor and the IRS, most are not required to reveal their equity holdings, and no such data are collected, summarized, or reported. The situation is further complicated, because investment management of a pension fund may be divided among several managers. Therefore, data are fragmented, and no one seems to have a detailed overview of the category. Nevertheless, an estimate was undertaken because of the extremely large number of indirect stockowners contributed by this category. The estimate, which was developed as logically as possible, using the best available data, must nonetheless be viewed cautiously.

In general, participants and annuitants are indirect owners of stock through pension funds. The total number of people covered by and receiving benefits from private pension sources by year-end 1979 was revealed in an unpublished survey of 8,000 civilian workers by the Department of Commerce.1/ This new survey identifies 41.3 million unduplicated individuals covered on the current job or receiving benefits from at least one private pension plan. Although the Commerce Department did not distinguish between "insured" funds (those insured and managed by insurance companies) and "non-insured" funds (managed by banks, investment counsel and internally), it was necessary to do so for the purposes of this estimate.

Prior to recent findings, the NYSE based its estimate of indirect shareowners through private pension funds on available data which indicated the total number of people covered by insured plans as 23 million2/ and for non-insured plans 30 million.3/ This study assumed that these figures, which contain some duplication, would remain in the same proportion to each other if unduplicated. Accordingly, 43% (insured) and 57% (non-insured) were applied to 41.3 million, yielding 17.8 million participants and annuitants of insured pension funds and 23.5 million for non-insured funds.

The proportions of insured and non-insured funds investing in oil stocks were then estimated separately. Insured pension monies are invested through general and separate accounts. At year-end 1979, 83% of insured pension reserves were known to be invested through the former, and 17% through the latter type of account.4/ According to findings in this study, about 55% of stock and mutual life insurance general accounts invest in one or more of the oil stocks. Vickers' report on 50 separate account portfolios shows that 76% owned one or more of the oil stocks.5/ Weighting by amount of reserves invested produced an estimate of 59% of insured pension funds invested in one or more of the oil stocks. Multiplying this proportion by all people covered by and receiving insured pension benefits -- which necessarily bears some relation to the assets of the funds -- resulted in 10.5 million indirect owners of oil stocks.

Estimating indirect shareownership through non-insured pension funds depended on gauging the relative importance of, and the degree to which, the three types of non-insured fund managers invest in oil stock. Although the exact proportions of amounts managed by these groups is unknown, about 65% is reasonably attributed to banks, 35% to investment counsel, and less than 2% to in-house managers.6/

The best available information which could be used to estimate non-insured pension fund holdings was based on SEC 13f filings by institutional investors handling $100,000,000 or more in equity assets. Vickers Guide to Bank Trust Portfolios showed that 99% of 117 bank trusts, with discretion over vast sums of pension money, owned one or more of the oil stocks.7/ Spectrum 4 showed 26% of investment counseling firms primarily managing pension monies invested in one or more of the oil stocks.8/ The same source also revealed that 82% of major internally-managed pension funds owned one or more of the oil stocks. Taking into account the relative weight of each type of managed fund, and allowing slight variation in investment patterns for small institutions, 95% of non-insured funds were estimated to own one or more of the 16 oil stocks. Multiplied by the number of participants and annuitants of non-insured pension funds, this yields 22.3 million. Adding both totals together, the number of indirect owners of oil company stocks through all private pension funds was estimated to be 32.8 million.

1/ Unpublished Data, 1979 Pension Fund Recipients, Workers Covered by Pension Funds, 1979, Current Population Survey, U.S. Department of Commerce, Bureau of the Census.

2/ Life Insurance Fact Book, 1980, American Council of Life Insurance, Washington, D.C. Total as of year-end 1979.

3/ Latest data provided by Social Security Administration were for year-end 1975. Annual growth rate for this institutional group was fairly small and steady (2.8%) for the previous five-year period of 1970-1975 and was assumed to apply to the period 1976-1979.

4/ Op-cit, "Private Pension Plans in the United States with Life Insurance Companies," pg. 54.

5/ Vickers Guide to Insurance Company Portfolios, Vickers Associates, Huntington, N.Y., September 1980.

6/ Estimates based on discussions with analysts at Money Market Directory.

7/ Vickers Guide to Bank Trust Portfolios, Vickers Associates, Huntington, N.Y., March 1981.

8/ Spectrum 4, Computer Direction Advisors, Inc., Silver Spring, Md., December 1980.

ESTIMATE OF STATE AND LOCAL PENSION FUND PARTICIPANTS AND ANNUITANTS: 1,774,000

To estimate the number of indirect owners of oil stocks through public pension funds required separating state and local fund data from published totals which combine the two categories. The Department of Commerce report of governmentally-administered employee-retirement systems1/ provided a ratio of state and local fund assets. These were applied to more comprehensive SEC public pension fund asset totals,2/ as well as Department of Commerce accounts of all people covered by and receiving pension benefits.3/ All figures are based on 1979 data and break down as follows:

State Pension Funds	Local Pension Funds
Total Assets: $139,542,000,000	Total Assets: $39,358,000,000
Total Workers Covered and Recipients: 8,984,800	Total Workers Covered and Recipients: 2,354,200

State Pension Funds

To determine the extent of investment in the 16 oil companies by state retirement systems, the NYSE conducted a survey of 93 state and teacher pension funds. Questionnaires were mailed to all participants in the 1980 Pension World Survey of State Retirement Systems, covering all states and 95% of total state fund assets. Nearly 9 out of 10 of these funds responded. Since this sample represented 48 states and 91% of total assets, findings based on it could be confidently projected. Results showed that 92% of state funds, according to assets, owned one or more of the oil stocks.

Indirect shareownership of oil company stock through this category was then calculated by multiplying the number of state fund participants and annuitants, 8,984,800, by the percent of state fund assets invested in oil stocks, 92%, for an estimated total of 8,266,000.

Local Pension Funds

To gauge the degree of local pension fund investment in all stocks, the 1979 Pension World Common Stockholdings of Municipal Retirement funds was consulted. Though imperfect, the 50 fund sample represented 44% of total local fund assets, covered 19 states, included 13 of the largest local pension funds and could provide a reasonable estimate.

However, because Pension World did not present ownership of oil stocks in the format used in this study, a probability formula was applied to the known data and the missing information assumed:

> Given that 40 funds owned any stock at all, and 20 owned the most widely-held oil stock, and specific numbers held the other 15, it was assumed that only half of the funds holding each of the second through sixteenth oil companies were different from those owning the most widely held. (Example: Only 9 of the 18 funds holding the second most widely-held company were assumed to be different from the 20 holding the most widely held, etc.). Applying the "General Law of Addition" to the resulting probabilities for each of the 16 companies, the probability of municipal retirement funds owning at least one of the 16 oil companies was computed to be .70 or 70%.

To estimate the number of indirect shareowners through local pension funds, the percentage of funds investing in oil stock, 70%, was multiplied by the known universe of local fund participants and annuitants, 2,534,200, yielding 1,774,000.

1/ Table 27: Finances of State and Local Governmentally-Administered Employee-Retirement Systems, 1978-1979, Governmental Finance in 1978-1979, U.S. Department of Commerce, Bureau of Census.

2/ Table A-500: Assets of Private and Public Pension Funds; SEC Bulletin, Monthly Statistical Review, Volume 39, No. 8, August 1980.

3/ Unpublished Data, 1979 Pension Fund Recipients, Workers Covered by Pension Funds, 1979, Current Population Survey, U.S. Department of Commerce, Bureau of the Census.

ESTIMATE OF COMMON TRUST FUND BENEFICIARIES: 241,000

In the absence of centrally collected and reported portfolio holdings by bank common trust funds, the 1980 Trusts & Estates annual common trust survey[1] was used to determine fund ownership of the 16 oil companies. The 456 fund sample was deemed representative in size and type of the total population as defined by the Federal Financial Institutions Examination Council.[2] Hence, results could be projected to the 2,356 funds existing as of year-end 1979.

While Trusts & Estates survey reported the number of funds owning various stocks, including the 16 oil stocks, it did not show fund ownership of any specific category. To estimate the number of common trust funds owning one or more of the 16 oil stocks, it was necessary to apply a probability formula to the known data and to assume the missing information:

> Given that 240 funds owned any stock at all, 170 owned the most widely-held oil stock, and specific numbers held the other 15, it was assumed that only one-fourth of the funds holding each of the second through sixteenth oil companies were different from those owning the most widely held. (Example: Only 26 of the 105 funds holding the second most widely-held stock were assumed to be different from the 170 holding the most widely-held, etc.). Applying the "General Law of Addition" to the resulting probabilities for each of the 16 companies, the probability of the common trust funds owning at least one of the 16 oil companies was computed to be .526 for all funds and 1.0 for common stockowning funds.

Therefore, all equity funds, all balanced funds and some fixed-income funds -- apparently 19% of the Trusts and Estates survey -- are likely to own oil stock. This results in a total of 267,484 common trust fund accounts invested in oil stocks, as follows:[3]

	# of Funds		# of Accounts	
Fund Type	Total	Own Oil Stocks	Total	Own Oil Stocks
Equity	861	861	196,875	196,875
Balanced	216	21	64,982	64,982
Fixed Income	829	17	274,032	5,627
Other	450	0	275,599	--
			811,488	267,484

However, since the same trust account may be invested in more than one fund, and most banks have more than one equity fund, the total must be reduced to eliminate internal duplication. Based on discussions with bank trust officials, it can be assumed that:

1.	Accounts invested in balanced funds are not duplicated.	(64,982)
2.	Tax-exempt fund accounts are also invested in one (growth) type equity fund, so that portion of equity fund accounts is not duplicated.	(69,927)
3.	This leaves 126,948 equity fund accounts of which two-thirds are thought to be unduplicated.	(84,547)
	Total unduplicated common trust fund accounts owning oil stocks	219,456

The resulting 219,456 unduplicated accounts must finally be expanded to reflect multiple beneficiaries, about 1.1 in the opinion of bank trust officials. This yields an estimated total 241,000 indirect shareowners of oil company stock through common trust funds.

1/ "31st Annual Common Trust Fund Survey," Trusts & Estates, pp 10-29. Reported stockholdings as of year-end 1979.

2/ Trust Assets of Banks and Trust Companies -- 1979, Federal Financial Institutions Examination Council, 1979, pg. 107.

3/ Ibid, pg. 10.

ESTIMATE OF COLLEGE ENDOWMENT FUND BENEFICIARIES (STUDENTS): 5,809,000

The Vickers guide to equity holdings of college and university endowment funds[1] served as the basis for estimating indirect oil company shareownership through this investment category. The 87-fund sample was considered adequately representative of all endowment funds in terms of fund assets, type of university (public or private) and enrollment size.[2] An examination of these portfolios shows 53% of the funds -- or 51% of the students enrolled in universities which have these funds -- owning one or more of the 16 oil stocks.[3]

Because endowment fund monies are used to construct and improve college facilities and provide student grants or scholarships, students are counted as indirect shareowners of endowment fund stockholdings. Although college faculties also benefit from endowment fund income which supports salaries and research grants, they are not included here because they have been counted under retirement plans. Therefore, since all institutions of higher education have such funds, all 11,391,000 students over 18 years old enrolled as of year-end 1979[4] could benefit from the underlying investments. To determine the number of students who stand to gain from oil company investments, 51% was multiplied by total adult enrollment. This resulted in an estimated 5,809,400 indirect shareowners of one or more of the 16 oil stocks through college endowment funds.

1/ Vickers College Endowment Fund Guide, Vickers Associates, Huntington, N.Y., March 1981.

2/ Fall Enrollment in Higher Education 1979, U.S. Department of Education, National Center for Education Statistics.

Special tabulations from Financial Statistics of Institutions of Higher Education, Fiscal Year 1979, U.S. Department of Education, National Center for Education Statistics.

3/ Education Directory, Colleges & Universities 1980-81, National Center for Education Statistics. Statistics based on Fall 1979 data.

4/ The number of "adult" students was calculated by multiplying the total enrollment in Fall 1980 by the proportion of students over 18 estimated in School Enrollment, Social and Economic Characteristics of Students, U.S. Department of Commerce, Bureau of the Census, October 1980.

API STUDY

16-Company Sample

May 1981

DETAILED TABLES

(NOTE: Numbers on first line of tables are rounded to thousands -- i.e., 2199 is 2,199,000.)

	Page Number
Have You Sold Any Oil Company Stock In The Past Eight Months (Since June 1980) (Q.2C)	1
Total Number Of Household Members Who Own Any Such Oil Company Shares (Not Including Respondent) (Q.3ABC)	2
How Many Such Adult Shareowners Of Oil Company Stocks Are There Age 21 Or Over In Your Household, Other Than Yourself? (Q.3AB)	3
How Many Such Minor Shareowners Of Oil Company Stocks Are There Under The Age Of 21 In Your Household (Q.3AC)	4
Do You Own Your Oil Company Shares Alone (Singly) Or Jointly (With Someone Else)? (Q4A)	5
Are Any Of Your Oil Company Shares Registered In The Broker's Name Instead Of Your Own Name -- That is, In Street Name As In A Margin Account? (Q.4B)	6
Are Any Of Your Oil Company Shares Registered In Your Own Name (Q.4C)	6
Please tell me Whether You Currently Own Any Of The Following Specific Types Of Investments. What about. . . (Q.5)	7
Market Value Currently Have Invested In Common And Preferred Stock (Q.6ABCD)	8
Out Of The Total Market Value of Your Common And Preferred Stocks, About What Percentage Is In Oil Company Stocks? (Q. 6E)	9
And Out Of The Total Market Value Of All Your Current Investments, Not Including Your Home Or Personal Possessions, About What Percentage Is In Any Kind Of Common And Preferred Stock (Q.6F).	10
What Is Your Approximate Age? (CL.1)	11
What Was The Last Grade Of School You Completed (CL.2)	12
In Which Category Does The Total Income Of Your Household For 1980 Fall - - Would It Be. . .? (CL.3)	13
Occupation Of Respondent (CL.4AB)	14
Marital Status Of Respondent (CL.5)	15
Sex of Respondent	16
Region	17

Q.2C 'HAVE YOU SOLD ANY OIL COMPANY STOCK IN THE PAST EIGHT MONTHS (SINCE JUNE 1980)

		1980 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M-24.9M	$25M-34.9M	$35M-49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FE-MALE	OIL PROF. EXORB	TAX WFALL PRCF.	OIL 75%G TOTAL STOCK
TOTAL	2159 100.0	361 100.0	423 100.0	346 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	604 100.0	416 100.0	1019 100.0	1180 100.0	917 100.0	649 100.0	410 100.0
YES	6.9	7.1	8.6	10.0	6.2	4.9	4.8	7.1	6.7	6.0	10.0	8.9	5.2	5.0	7.0	7.5
NO	92.7	92.9	90.0	90.0	93.0	95.1	95.2	92.9	92.1	93.5	90.0	90.8	94.3	94.4	93.0	92.5
DON'T KNOW	0.4		1.4		0.8				1.2	0.5		0.3	0.5	0.6		

Q7ABC TOTAL NUMBER OF HOUSEHOLD MEMBERS WHO OWN ANY SUCH OIL COMPANY SHARES(NOT INCLUDING RESPONDENT)

		1980 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M-24.9M	$25M-34.9M	$35M-49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FE-MALE	OIL PROF. EXORB	TAX WFALL PROF.	OIL 75%+ TOTAL STOCK
TOTAL	2159 100.0	361 100.0	423 100.0	346 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	604 100.0	416 100.0	1019 100.0	1140 100.0	917 100.0	649 100.0	410 100.0
ONE	34.3	15.2	32.0	39.8	47.0	40.2	31.6	40.3	38.3	35.3	25.3	41.4	28.2	33.2	34.4	35.6
TWO	2.8	-	3.0	1.9	3.2	6.0	4.1	6.3	3.7	0.4	1.5	1.4	4.1	2.2	3.7	2.0
THREE	1.5	0.8	0.9	0.5	1.0	4.2	3.0	4.7	0.6	-	0.8	1.3	1.6	1.7	1.0	1.6
FOUR	1.0	-	0.8	0.8	1.7	1.8	1.0	2.7	0.6	0.9	-	1.1	0.8	0.4	-	-
FIVE	0.1	-	-	-	-	1.0	-	0.9	-	-	-	0.3	-	-	-	-
SIX OR MORE	0.2	-	-	-	-	1.1	-	1.0	-	-	-	0.3	-	-	-	-
DON'T KNOW/REFUSED	0.2	-	0.7	-	-	-	-	-	1.1	-	-	0.5	-	-	0.4	-
NONE	59.9	83.9	62.8	56.5	47.1	45.6	60.3	44.2	55.8	63.4	72.4	53.7	65.2	62.4	60.5	58.9

Q2AB HOW MANY SUCH ADULT SHAREOWNERS OF OIL COMPANY STOCKS ARE THERE AGE 21 OR OVER IN YOUR HOUSEHOLD, OTHER THAN YOURSELF?

		1980 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M-24.9M	$25M-34.9M	$35M-49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FE-MALE	OIL PROF. EXCSS	TAX WFALL PROF.	OIL 75%+ TOTAL STOCK
TOTAL	2199 100.0	361 100.0	423 100.0	346 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	604 100.0	416 100.0	1019 100.0	1180 100.0	517 100.0	649 100.0	410 100.0
ONE	36.2	16.1	32.8	40.7	48.2	45.4	35.5	46.6	39.4	34.9	26.1	42.4	30.9	34.3	35.8	39.7
TWO	1.9	-	1.4	-	2.5	6.0	1.2	5.2	3.2	-	0.8	1.1	2.6	2.2	2.3	1.4
THREE	0.4	-	-	0.9	0.8	1.2	-	1.0	0.6	-	0.8	0.6	0.3	-	-	-
FOUR	0.4	-	0.8	0.6	-	0.8	1.0	-	-	0.5	-	0.5	0.3	0.4	-	-
FIVE	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
SIX OR MORE	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
DON'T KNOW/REFUSED	0.2	-	0.7	-	-	-	-	-	1.1	-	-	0.5	-	-	0.4	-
NONE	60.9	83.9	64.4	57.5	48.5	46.6	62.3	47.1	55.8	64.3	72.4	54.9	66.0	63.0	61.4	58.9

Q9AC HOW MANY SUCH MINOR SHAREOWNERS OF OIL COMPANY STOCKS ARE THERE UNDER THE AGE OF 21 IN YOUR HOUSEHOLD?

		1980 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M-24.9M	$25M-34.9M	$35M-49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FE-MALE	OIL PROF. EXCSD	TAX WFALL PROF.	OIL 75%+ TOTAL STOCK
TOTAL	2199 100.0	361 100.0	423 100.0	346 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	604 100.0	416 100.0	1019 100.0	1180 100.0	917 100.0	649 100.0	410 100.0
ONE	1.4	-	0.8	0.9	1.6	4.1	2.0	3.4	1.1	0.5	0.7	0.8	1.8	1.0	1.4	1.5
TWO	1.3	0.0	0.8	1.0	1.7	2.0	2.8	3.9	0.6	0.4	-	1.0	1.5	1.0	1.4	1.6
THREE	0.6	-	0.8	-	0.9	2.0	1.1	2.6	-	-	-	0.6	0.5	0.4	-	-
FOUR	0.1	-	-	-	-	-	-	0.9	-	-	-	0.3	-	-	-	-
FIVE	0.2	-	-	-	-	1.1	-	1.0	-	-	-	0.3	-	-	-	-
SIX OR MORE	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
DON'T KNOW/REFUSED	0.1	-	-	-	-	-	-	-	0.5	-	-	0.2	-	-	-	-
NONE	96.4	99.2	97.6	98.1	95.8	90.8	94.1	88.1	97.8	99.1	99.3	96.6	96.1	97.6	97.2	96.9

Q4A DO YOU OWN YOUR OIL COMPANY SHARES ALONE (SINGLY) OR JOINTLY (WITH SOMEONE ELSE)?

		1990 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M-24.9M	$25M-34.9M	$35M-49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FE-MALE	OIL PROF. EXCRB	TAX WFALL PROF.	OIL 75%+ TOTAL STOCK
TOTAL	2199 100.0	361 100.0	423 100.0	346 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	604 100.0	416 100.0	1019 100.0	1180 100.0	917 100.0	649 100.0	410 100.0
ALONE	69.8	79.7	68.9	64.9	64.3	71.3	73.6	58.6	64.4	72.9	78.1	65.6	73.3	68.9	68.7	63.9
JOINTLY	23.8	17.7	28.3	27.8	30.0	19.7	21.2	33.0	27.4	20.6	18.7	27.8	20.4	27.1	27.1	29.8
BOTH WAYS	6.4	2.5	2.8	7.3	5.7	9.1	5.3	8.4	8.2	6.5	3.2	6.6	6.2	4.0	4.2	6.3
DON'T KNOW/REFUSED	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

Q4B ARE ANY OF YOUR OIL COMPANY SHARES REGISTERED IN THE BROKER'S NAME INSTEAD OF YOUR OWN NAME -- THAT IS, IN STREET NAME AS IN A MARGIN ACCOUNT? Q4C ARE ANY OF YOUR OIL COMPANY SHARES REGISTERED IN YOUR OWN NAME?

		1980 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M-24.9M	$25M-34.9M	$35M-49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FE-MALE	OIL PROF. EXORB	TAX WFALL PROF.	OIL 75%+ TOTAL STOCK
TOTAL	2199 100.0	361 100.0	423 100.0	346 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	604 100.0	416 100.0	1019 100.0	1180 100.0	917 100.0	645 100.0	410 100.0
OWN OIL COMPANY SHARES REGISTERED IN THE BROKERS NAME	4.3	1.1	3.3	3.8	8.9	0.9	4.2	8.7	4.8	2.7	2.4	5.8	3.0	4.1	2.6	3.7
ALSO OWN IN OWN NAME	3.2	-	2.7	2.8	7.0	7.0	2.4	5.5	3.3	2.7	2.4	4.6	2.0	3.3	1.5	2.2
DON'T OWN IN OWN NAME	1.0	1.1	0.6	1.0	1.7	1.9	1.0	3.2	1.5	-	-	1.3	0.7	0.8	1.1	0.8
DON'T KNOW/REFUSED	0.1	-	-	-	-	-	0.8	-	-	-	-	-	0.2	-	-	0.7
DON'T OWN OIL COMPANY SHARES REGISTERED IN THE BROKERS NAME	94.2	98.1	95.8	94.0	89.5	90.2	93.6	88.3	95.2	96.0	96.1	93.0	95.4	94.7	96.8	95.5
DON'T KNOW/REFUSED	1.5	0.9	0.9	2.1	1.7	0.9	2.3	3.0	-	1.4	1.5	1.2	1.7	1.2	0.6	0.7

Q5 PLEASE TELL ME WHETHER YOU CURRENTLY OWN ANY OF THE FOLLOWING SPECIFIC TYPES OF INVESTMENTS. WHAT ABOUT...

		1980 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M-24.9M	$25M-34.9M	$35M-49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FEMALE	OIL PROF. EXORB	TAX WFALL PROF.	OIL 75%+ TOTAL STOCK
TOTAL	2159 100.0	361 100.0	423 100.0	346 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	604 100.0	416 100.0	1019 100.0	1140 100.0	917 100.0	649 100.0	410 100.0
LIFE INSURANCE	60.5	52.6	55.9	70.5	64.6	67.5	66.0	74.4	61.7	59.4	45.0	72.0	50.6	59.8	59.4	81.4
INVESTMENT REAL ESTATE OTHER THAN YOUR HOME	28.1	10.7	23.1	24.8	38.9	43.7	32.5	40.2	30.6	23.0	19.1	28.2	28.1	27.4	24.9	22.0
PASSBOOK SAVINGS ACCOUNT	86.3	85.7	88.8	86.3	87.5	83.5	83.2	81.7	88.0	88.0	86.8	84.5	87.9	85.3	90.7	78.8
CORPORATE BONDS	28.6	11.1	27.7	26.4	36.6	39.6	21.4	22.7	31.5	29.8	33.7	30.8	26.6	25.1	28.8	4.3
COMMON STOCK OTHER THAN OIL COMPANY STOCK	85.9	77.9	86.9	79.6	87.2	96.2	84.3	83.6	85.9	86.5	88.4	84.6	87.1	80.4	66.5	30.9
PREFERRED STOCK OTHER THAN OIL COMPANY STOCK	33.7	29.2	36.6	32.1	33.0	39.8	24.3	32.4	32.7	35.5	40.6	33.7	33.6	29.8	32.0	3.5
STOCK MUTUAL FUNDS	28.9	21.7	24.9	37.0	32.3	31.9	22.5	34.4	28.4	29.0	29.8	29.0	29.6	26.5	35.6	13.5
MONEY MARKET FUNDS	46.5	39.2	42.7	47.4	52.9	62.6	41.9	48.0	50.2	48.2	42.3	46.7	46.4	46.6	51.6	36.8
DON'T KNOW/REFUSED	0.9	2.2	-	-	1.1	-	1.2	2.2	0.6	0.9	-	0.9	0.9	1.2	1.7	4.1

CHARCO MARKET VALUE CURRENTLY HAVE INVESTED IN COMMON AND PREFERRED STOCK

		1980 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M- 24.9M	$25M- 34.9M	$35M- 49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FE-MALE	OIL PROF. EXORB	TAX WFALL PROF.	OIL 75%+ TOTAL STOCK
TOTAL	2159 100.0	361 100.0	423 100.0	346 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	604 100.0	416 100.0	1019 100.0	1180 100.0	917 100.0	645 100.0	410 100.0
UNDER $10,000	15.3	28.4	17.4	17.6	12.9	6.1	31.7	22.6	7.9	10.5	12.2	13.7	16.7	18.3	13.6	32.9
10,000 - 24,999	14.5	23.8	18.4	20.0	13.5	8.0	16.4	17.3	16.0	15.2	7.7	14.2	14.8	17.5	14.0	22.9
25,000 - 49,999	15.0	19.7	18.1	14.5	13.5	12.9	10.4	14.5	14.8	19.0	14.9	12.3	17.3	16.5	17.1	15.2
50,000 - 99,999	15.3	8.8	18.2	20.8	21.6	15.1	14.3	14.4	15.0	15.8	16.1	16.9	13.8	13.1	13.4	10.0
100,000 AND OVER	19.6	4.2	14.5	18.1	31.5	50.7	7.9	9.6	24.3	24.7	24.2	26.3	13.8	14.0	18.7	7.2
DON'T KNOW/REFUSED	20.3	15.0	13.4	8.9	7.1	7.2	19.3	21.6	22.0	15.7	24.8	16.6	23.6	20.2	23.3	11.8
MEDIANS	41.7	19.9	35.3	38.7	65.2		17.9	24.4	50.9	47.8	58.5	54.6	34.7	31.0	40.8	17.3

6E OUT OF THE TOTAL MARKET VALUE OF YOUR COMMON AND PREFERRED STOCKS,
ABOUT WHAT PERCENTAGE IS IN OIL COMPANY STOCKS?

		1980 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M-24.9M	$25M-34.9M	$35M-49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FE-MALE	OIL PROF. EXCRD	TAX WF/LL PROF.	OIL 75%+ TOTAL STOCK
TOTAL	2199 100.0	361 100.0	423 100.0	346 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	604 100.0	416 100.0	1019 100.0	1180 100.0	917 100.0	645 100.0	410 100.0
UNDER 10%	14.3	9.0	11.4	14.0	17.4	15.4	6.0	16.7	14.2	17.8	14.1	14.6	14.1	14.6	15.3	-
10-14%	15.9	14.2	17.7	18.2	14.2	17.4	17.7	16.8	15.9	15.5	14.5	14.6	17.0	17.8	18.8	-
15-24%	11.4	9.9	14.6	9.9	10.9	20.6	14.4	8.2	11.0	13.2	9.8	13.4	9.7	8.8	15.1	-
25-49%	14.9	18.1	14.5	13.4	17.0	22.6	14.2	11.5	15.2	12.3	21.8	15.9	14.1	8.7	10.0	-
50-74%	9.0	8.4	13.4	12.7	6.6	9.4	17.0	11.9	6.5	7.1	6.1	11.3	7.0	9.0	9.3	-
75-99%	5.9	6.1	6.4	5.5	7.3	6.4	4.8	10.1	8.5	3.3	3.9	6.8	5.1	5.5	3.9	31.6
100%	12.8	20.3	12.4	20.4	12.8	3.6	14.6	15.6	13.6	12.3	8.6	14.7	11.1	17.3	12.1	68.4
DON'T KNOW	13.5	13.0	9.6	6.1	13.7	4.4	9.2	7.5	13.2	16.0	18.5	7.0	19.1	14.7	11.8	-
REFUSED	2.3	0.9	-	-	-	-	2.1	1.7	2.1	2.6	2.7	1.7	2.8	3.2	3.6	-
MEANS	36.9	44.7	37.7	42.2	36.6	29.1	40.7	41.7	38.2	33.5	32.2	38.9	34.9	40.7	33.4	94.6
MEDIANS	25.3	38.6	27.6	34.2	25.9	22.3	36.1	33.0	27.2	20.7	26.2	29.7	23.2	24.8	20.4	

OF AND OUT OF THE TOTAL MARKET VALUE OF ALL YOUR CURRENT INVESTMENTS, NOT INCLUDING YOUR HOME OR PERSONAL POSSESSIONS, ABOUT WHAT PERCENTAGE IS IN ANY KIND OF COMMON AND PREFERRED STOCK?

		1986 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M-24.9M	$25M-34.9M	$35M-49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FE-MALE	OIL PROF. EXORB	TAX WFALL PROF.	OIL 75%+ TOTAL STOCK
TOTAL	2199 100.0	361 100.0	423 100.0	346 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	664 100.0	416 100.0	1019 100.0	1180 100.0	917 100.0	649 100.0	410 100.0
UNDER 10%	5.1	4.1	5.8	8.5	4.9	2.6	9.5	6.0	4.0	3.9	4.1	8.0	2.6	8.1	6.2	14.2
10-14%	6.1	11.3	3.8	5.4	11.0	3.8	4.2	4.2	6.8	7.1	6.9	5.5	6.6	7.0	4.0	9.0
15-24%	5.6	5.5	3.8	11.9	3.8	7.0	9.4	8.7	5.3	3.9	2.7	6.2	5.0	6.6	5.4	5.4
25-49%	16.7	10.6	22.7	25.1	16.8	21.6	22.3	20.4	15.8	13.2	15.5	18.8	15.0	16.6	18.8	6.8
50-74%	21.2	17.3	22.5	18.6	27.9	26.7	16.9	24.9	20.7	21.0	22.2	23.4	19.3	17.7	25.9	15.8
75-99%	18.1	18.9	19.9	15.0	18.6	29.2	21.3	9.5	21.5	19.9	16.2	21.2	15.5	13.0	15.0	18.3
100%	2.5	4.8	2.3	1.0	3.7	-	1.2	3.4	2.4	3.2	2.1	3.3	1.9	2.1	2.2	7.2
DON'T KNOW	20.0	23.3	17.7	12.5	12.6	9.0	12.2	16.4	20.3	21.9	26.0	9.5	29.1	24.4	17.3	17.1
REFUSED	4.6	4.3	1.4	1.9	0.8	-	3.1	6.5	3.2	5.9	4.2	4.2	5.1	4.5	5.0	6.1
MEANS	48.3	50.0	48.9	40.6	48.7	52.1	45.4	43.1	49.6	51.5	49.5	48.8	47.8	41.8	47.4	46.2
MEDIANS	54.9	56.9	54.7	41.8	56.1	59.8	46.6	49.1	57.6	59.5	56.4	55.0	54.9	45.9	54.2	54.6

DREHL & ASSOCIATES — ENERGY STUDY — TABLE 19

C1.1 WHAT IS YOUR APPROXIMATE AGE?

		1980 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M-24.9M	$25M-34.9M	$35M-49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FE-MALE	OIL PROF. EXORB	TAX WFALL PROF.	OIL 75%+ TOTAL STOCK
TOTAL	2199 100.0	361 100.0	423 100.0	346 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	604 100.0	416 100.0	1019 100.0	1180 100.0	917 100.0	649 100.0	410 100.0
UNDER 21	0.2	-	0.8	-	-	-	1.0	-	-	-	-	-	0.3	0.4	-	-
21 - 24	0.2	-	0.9	-	-	-	1.1	-	-	-	-	0.4	-	0.4	0.6	-
25 - 34	5.1	5.2	4.7	9.3	3.0	4.2	34.6	-	-	-	-	4.7	5.6	6.4	4.8	3.3
35 - 44	9.4	1.1	10.4	6.1	14.8	16.5	63.2	-	-	-	-	9.3	9.5	8.5	10.3	12.2
45 - 54	15.8	4.5	14.0	24.9	16.9	19.5	-	100.0	-	-	-	16.3	15.3	17.5	18.7	21.7
55 - 64	23.0	18.7	23.6	21.3	26.1	28.2	-	-	100.0	-	-	23.0	22.9	24.2	20.7	27.2
65 - 74	27.5	39.2	28.9	23.3	23.2	21.9	-	-	-	100.0	-	29.2	26.6	25.3	30.5	22.9
75 OR OVER	18.9	31.4	16.7	15.0	16.1	9.7	-	-	-	-	100.0	17.2	20.4	16.5	14.3	12.7
DON'T KNOW/REFUSED	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
MEDIANS	63.4	70.3	63.1	59.5	60.9	58.5	37.1	50.0	60.0	70.0		63.4	63.4	61.8	62.5	59.7

CL.2 WHAT WAS THE LAST GRADE OF SCHOOL YOU COMPLETED?

		1980 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M-24.9M	$25M-34.9M	$35M-49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FE-MALE	OIL PROF. EXORB	TAX WFALL PROF.	OIL 75%+ TOTAL STOCK
TOTAL	2199 100.0	361 100.0	423 100.0	346 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	684 100.0	416 100.0	1019 100.0	1180 100.0	917 100.0	645 100.0	410 100.0
SOME ELEMENTARY	0.4	1.7	0.7	-	-	-	-	-	-	0.5	1.5	0.9	-	0.6	0.4	-
COMPLETED ELEMENTARY SCHOOL	2.5	6.8	2.6	1.8	-	0.7	-	-	-	3.9	7.5	2.6	2.4	2.9	-	4.3
SOME HIGH SCHOOL	5.0	7.0	7.1	4.7	1.6	1.0	2.1	4.0	2.9	6.1	9.0	5.6	4.4	7.7	6.2	9.8
COMPLETED HIGH SCHOOL	17.2	26.3	22.3	14.9	11.9	8.4	13.7	18.8	15.5	18.8	18.5	15.1	19.0	21.3	15.5	27.5
SOME COLLEGE	15.9	14.8	22.2	14.7	13.3	12.6	12.5	18.5	17.6	14.3	17.0	13.1	10.4	11.3	13.3	14.8
BUSINESS OR TECHNICAL SCHOOL	6.0	10.2	7.2	4.0	5.1	2.5	2.0	1.0	6.7	8.3	9.2	5.2	6.8	7.4	5.4	5.8
COMPLETED COLLEGE	31.5	24.9	21.8	34.5	41.4	38.7	37.6	30.2	33.5	32.5	24.0	31.7	31.4	28.3	32.0	29.3
GRADUATE STUDY	20.8	7.5	16.2	25.3	26.6	36.1	32.0	27.5	23.8	13.8	12.7	25.6	16.7	19.8	26.5	9.2
DON'T KNOW/REFUSED	0.6	0.8	-	-	-	-	-	-	-	1.8	0.6	0.2	0.9	0.6	0.8	-
MEDIANS	16.1	14.0	14.8	16.2	16.4	16.6	16.5	16.3	16.2	15.7	14.5	16.2	15.9	15.8	16.3	14.3

C1.3 IN WHICH CATEGORY DOES THE TOTAL INCOME OF YOUR HOUSEHOLD FOR 1980 FALL --
WOULD IT BE...?

		1980 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M-24.9M	$25M-34.9M	$35M-49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FE-MALE	OIL PROF. EXORB	TAX WFALL PROF.	OIL 75%+ TOTAL STOCK
TOTAL	2159 100.0	361 100.0	423 100.0	346 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	604 100.0	416 100.0	1019 100.0	1160 100.0	917 100.0	649 100.0	410 100.0
UNDER $10,000	7.9	48.3	-	-	-	-	2.2	2.4	4.4	10.6	17.3	5.4	10.1	9.4	7.2	14.0
10,000 - 14,999	8.5	51.7	-	-	-	-	4.7	2.2	8.9	12.8	9.9	7.5	9.3	9.5	8.1	9.2
15,000 - 19,999	9.5	-	49.5	-	-	-	9.0	8.1	10.2	11.2	7.8	8.0	10.8	10.3	10.1	9.5
20,000 - 24,999	9.7	-	50.5	-	-	-	12.6	9.1	9.6	9.0	9.2	8.8	10.5	12.0	10.1	9.9
25,000 - 34,999	15.7	-	-	100.0	-	-	16.3	24.9	14.6	13.4	12.5	18.0	13.8	17.0	14.3	21.8
35,000 - 49,999	16.2	-	-	-	100.0	-	19.4	17.4	18.4	13.7	13.8	22.4	10.9	12.0	16.4	17.5
50,000 - 99,999	9.8	-	-	-	-	72.4	15.1	10.7	10.9	8.7	5.2	10.9	8.8	7.7	11.8	5.8
100,000 AND OVER	3.7	-	-	-	-	27.6	3.8	6.1	5.6	2.1	1.7	4.9	2.7	4.2	4.1	0.6
DON'T KNOW/REFUSED	18.8	-	-	-	-	-	16.8	19.1	17.3	18.5	22.5	14.0	23.0	17.8	17.5	10.7
MEDIANS	28.1	10.2	20.1	30.0	42.5	84.5	33.0	32.5	30.6	23.4	22.0	32.4	23.9	24.5	28.9	26.0

CL.4AB OCCUPATION OF RESPONDENT

	TOTAL	1980 HOUSEHOLD INCOME UNDER $15M	$15M-24.9M	$25M-34.9M	$35M-49.9M	$50M AND OVER	AGE OF RESPONDENT UNDER 45	45-54	55-64	65-74	75 AND OVER	SEX MALE	FE-MALE	ATTITUDES OIL PROF. EXORB	TAX WFALL PROF.	OIL 153+ TOTAL STOCK
TOTAL	2199 100.0	361 100.0	423 100.0	345 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	604 100.0	416 100.0	1019 100.0	1180 100.0	917 100.0	659 100.0	410 100.0
EMPLOYED	38.2	18.7	36.6	49.2	55.2	49.7	71.0	74.8	47.8	12.8	7.0	52.5	25.9	39.3	43.7	37.2
PROFESSIONAL OR TECHNICAL	17.4	6.6	11.1	25.5	29.7	24.0	39.3	30.6	19.3	6.3	2.8	22.9	12.6	19.3	18.5	8.6
MANAGERS,OFFICIALS,PROPRIETORS	8.3	0.8	7.7	8.9	10.1	16.5	12.3	17.6	11.5	2.3	2.1	13.0	4.2	7.4	11.1	8.4
CLERICAL,SALES,OTHER WHITE COLLAR	8.1	8.0	13.6	7.1	7.5	6.7	11.7	15.8	12.9	2.7	0.7	8.7	7.5	6.5	8.4	8.9
CRAFTSMEN,FOREMEN	0.3	-	0.7	1.0	-	-	-	1.0	-	0.5	-	0.3	0.2	0.7	-	0.8
OPERATIVES,LABORERS	2.7	0.9	3.7	3.7	5.9	-	4.4	6.0	4.1	0.5	-	4.9	0.7	4.1	3.6	9.8
FARMERS,FARM LABORERS	0.6	0.9	-	0.9	-	2.2	1.1	0.9	-	0.5	0.8	1.3	-	0.3	-	-
SERVICE WORKERS	0.4	0.7	-	1.0	-	-	-	1.9	-	-	0.6	0.6	0.3	0.4	0.5	0.6
ARMED FORCES	0.2	-	-	-	1.0	-	1.1	-	-	-	-	0.4	-	-	0.6	-
NOT CLASSIFIED BY OCCUPATION	0.3	-	-	1.1	1.0	-	1.1	1.1	-	-	-	0.4	0.3	0.8	1.2	-
NOT EMPLOYED	61.7	81.3	63.4	50.8	44.8	50.3	29.0	24.2	52.2	87.2	93.0	47.5	73.9	60.7	56.3	62.8
RETIRED	40.8	61.2	44.4	34.6	27.1	38.9	-	1.8	30.5	68.7	77.7	45.8	36.5	39.4	38.2	39.4
A STUDENT	0.4	-	0.8	-	0.9	1.0	3.0	-	-	-	-	-	0.8	0.7	1.0	-
A HOUSEWIFE	19.6	17.1	17.4	16.2	16.8	10.4	23.8	22.4	21.0	17.9	14.6	-	36.5	19.1	15.9	21.6
UNEMPLOYED	0.7	3.1	0.8	-	-	-	2.2	-	0.8	0.5	-	1.4	-	1.2	1.2	1.8
DON'T KNOW BUT EMPLOYED	0.1	-	-	-	-	-	-	-	-	-	0.6	0.3	-	0.3	-	-
REFUSED	0.2	-	-	-	-	-	-	1.0	-	-	-	-	0.3	-	-	-

CL.5 MARITAL STATUS OF RESPONDENT

		1980 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M- 24.9M	$25M- 34.9M	$35M- 49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FE- MALE	OIL PROF. EXORB	TAX WFALL PROF.	OIL 75%+ TOTAL STOCK
TOTAL	2199 100.0	361 100.0	423 100.0	346 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	604 100.0	416 100.0	1019 100.0	1180 100.0	917 100.0	649 100.0	410 100.0
MARRIED	67.5	36.9	56.1	77.4	84.3	89.4	75.7	88.3	71.4	63.6	44.5	81.7	55.1	61.7	70.4	74.[illegible]
SINGLE	8.9	14.9	16.9	7.1	1.9	3.3	18.0	4.3	9.8	8.6	5.1	7.1	10.5	12.5	10.5	3.7
SEPARATED	0.3	0.8	0.7	-	-	-	-	-	0.6	-	0.7	-	0.5	0.3	0.4	-
WIDOWED	19.6	42.5	21.8	10.2	12.1	5.6	1.9	3.3	10.8	26.0	48.2	8.7	28.9	20.7	14.2	19.3
DIVORCED	3.2	4.1	4.4	4.5	1.6	1.7	4.3	3.1	6.8	1.4	0.7	2.1	4.2	4.1	3.5	3.2
DON'T KNOW/REFUSED	0.5	0.8	-	0.9	-	-	-	1.0	0.6	0.4	0.7	0.3	0.8	0.7	0.9	0.7

SEX OF RESPONDENT

		1980 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M- 24.9M	$25M- 34.9M	$35M- 49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FE- MALE	OIL PROF. EXORB	TAX WFALL PROF.	OIL 75%+ TOTAL STOCK
TOTAL	2199 100.0	361 100.0	423 100.0	346 100.0	357 100.0	298 100.0	327 100.0	346 100.0	505 100.0	604 100.0	416 100.0	1019 100.0	1180 100.0	917 100.0	645 100.0	410 100.0
MALE	46.3	36.4	40.5	53.0	64.0	54.2	44.5	47.9	46.4	49.2	42.2	100.0	-	38.7	54.6	53.3
FEMALE	53.7	63.6	59.5	47.0	36.0	45.8	55.5	52.1	53.6	50.8	57.8	-	100.0	61.3	45.4	46.7

REGION

		1980 HOUSEHOLD INCOME					AGE OF RESPONDENT					SEX		ATTITUDES		
	TOTAL	UNDER $15M	$15M-24.9M	$25M-34.9M	$35M-49.9M	$50M AND OVER	UNDER 45	45-54	55-64	65-74	75 AND OVER	MALE	FEMALE	OIL PROF. EXORB	TAX WFALL PROF.	OIL 75%+ TOTAL STOCK
TOTAL	2199	361	423	346	357	298	327	346	505	604	416	1019	1180	917	649	410
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
NORTHEAST	33.0	38.8	31.9	30.1	33.0	29.5	39.4	36.0	32.0	33.5	25.9	32.9	33.1	33.9	37.6	27.0
NEW ENGLAND	8.5	14.6	4.0	5.4	6.4	9.6	10.3	7.8	7.4	12.4	3.4	8.9	8.1	7.4	10.7	3.0
MIDDLE ATLANTIC	24.5	24.2	27.9	24.7	26.6	19.9	29.1	28.2	24.7	21.2	22.4	24.0	25.0	26.4	26.9	24.0
NORTH CENTRAL	23.0	20.3	24.2	25.5	20.2	22.1	16.3	24.2	24.2	21.4	28.2	24.7	21.6	25.2	26.9	24.6
EAST NORTH CENTRAL	16.6	13.5	16.8	21.0	14.5	15.9	11.1	14.8	17.7	17.1	20.5	17.7	15.7	16.6	20.4	15.9
WEST NORTH CENTRAL	6.4	6.8	7.5	4.4	5.7	6.2	5.2	9.4	6.5	4.3	7.7	7.0	5.8	8.6	6.6	8.7
SOUTH	28.4	24.9	30.4	32.2	28.5	32.6	30.9	24.1	28.3	30.1	27.6	27.6	29.0	27.8	18.6	36.9
WEST SOUTH CENTRAL	10.4	8.9	12.0	11.2	10.7	13.6	11.1	11.5	10.8	9.4	10.1	9.5	11.2	8.2	3.7	25.1
SOUTH ATLANTIC	14.3	13.4	14.8	16.2	12.6	16.5	14.8	9.5	13.4	17.4	14.3	14.6	13.9	16.8	13.4	8.1
EAST SOUTH CENTRAL	3.7	2.6	3.6	4.7	5.2	2.5	5.0	3.1	4.0	3.3	3.2	3.5	3.9	2.8	1.5	3.6
WEST	15.6	16.0	13.4	12.3	10.3	15.9	13.5	15.7	15.4	14.9	18.3	14.8	16.3	13.1	14.9	11.5
MOUNTAIN	3.8	4.5	3.7	0.8	5.1	5.7	4.5	1.0	2.8	5.0	4.8	3.9	3.6	3.8	2.7	3.5
PACIFIC	11.8	11.5	9.7	11.5	13.2	10.1	9.0	14.7	12.7	9.9	13.6	10.9	12.7	9.3	12.2	8.0

ADDITIONAL COMMENTS OF T. BOONE PICKENS, JR.

"In 1981 Mesa ran a $420 million exploration and production budget. In 1982, that budget was reduced to $332 million and further reduced in 1983 to $223 million. In each of these years, Mesa's exploration and production budget was in excess of its cash flow. In 1984, Mesa again reduced its exploration and production budget to $109 million, which is approximately 40 percent of its cash flow. Internal studies we have conducted show that most large companies spend approximately 40 percent of their cash flow on domestic exploration and production activities, so our budget is in line with others in the industry.

Mesa's budget has not been reduced because of its acquisition attempts, but because finding costs are too high. This is illustrated by another study that has been conducted at Mesa. This study reviewed the worldwide exploration and production figures for 300 publicly held companies. During the 1980-82 period, these companies spent approximately $166 billion on exploration and production activities. They discovered SEC valued reserves during this period of $109 billion. In other words, these companies discovered only 66¢ worth of reserves for every dollar they spent. It simply is not economically justified to conduct an aggressive exploration and production budget in the current climate of high finding costs, stable crude oil prices, and depressed demand for natural gas.

Similarly, reductions in Mesa's exploration budget have not been induced by the creation of royalty trusts. On the contrary, Mesa's highest historical exploration expenditures (200 percent of cash flow) were made after the creation of our first royalty trust in 1979. This underscores the fact that the level of exploration activity is governed primarily by finding costs, oil and gas prices, and market demand. The creation of a royalty trust simply does not reduce cash flow sufficiently to inhibit economically sensible levels of exploration.

On the issue of interest rates, my previous testimony stated that these acquisitions have not had an adverse impact on capital markets. Numerous authorities, including the Securities and Exchange Commission Advisory Committee on Tender Offers, and Dr. Leif Olson of Citibank, N.A. have indicated that these mergers do not adversely impact interest rates. These acquisitions are simply financial transactions that represent only a fraction of the $30 trillion in equity transactions that took place in 1983. Each day, billions of dollars of financial tranactions of this nature take place, and there is no reason to suspect that these acquisitions have any more effect on financial markets than any other equity transaction."

MS file

SOCal/Gulf Merger
FACT BOOK
March 20, 1984

1. Impact of Mergers on Exploration and Development of Oil and Gas Reserves

- The level of expenditure for exploration and development in the U.S. is determined by the economics of drilling for new reserves - the availability of prospects, the price of oil, the cost of finding and producing new reserves, and the fiscal regime. The fundamental variable affecting exploration expenditures is the world oil price set by the OPEC cartel.

- Exploration expenditure and funding are fundamentally separate from acquisition decisions, and each are decided on their independent merits.

- Evidence from many previous large oil acquisitions supports this: in Conoco-duPont, U.S. Steel-Marathon, and Shell-Belridge, the combined company stepped up expenditures significantly after the mergers despite increases in leverage and debt obligations.

- The continuing depletion of our oil and gas reserves has pushed the exploration frontier to remote and costly locations. These major exploration projects, like Mukluk, are inherently risky and can cost upwards of $1 billion, and mergers can increase the ability of the resulting company to participate in the search for new energy sources.

- Capital raised to buy an oil company doesn't disappear, but gets reinvested in the economy in the form of either reinvestment in the markets, new capital formation, or paying down loans. The data suggests that the overwhelming portion of the proceeds from a buyout goes for investment, not consumption.

2. Tax Issues

- o Tax revenues from the two pending mergers are estimated to be several billion dollars. The proposed legislation would block this.

- o Although the interest on the borrowings to finance these acquisitions is deductible, this deduction is offset by the taxable interest income received by the bank/depositor/ultimate providers of the funds. The result is a wash of income and expense for tax purposes, so the government is not subsidizing half the cost of the borrowing.

- o The oil and gas industry is provided with no special subsidies for mergers and acquisitions. Rather, incentives are provided only for continued exploration and development.

- o In the aggregate, especially including the windfall profits tax, the oil industry is one of the largest taxpayers in the U.S., accounting for a significant percentage of total corporate taxes paid.

3. Credit Issues

- o Mergers don't impact the overall supply of credit, as funds flow into stockholder's hands and from there into other forms of investment, such as stocks, bonds, money market funds, etc.

- o The Vice Chairman of the Federal Reserve Board has indicated on March 16, 1984 he sees no impact on credit markets due to these larger mergers.

- The amount of funds used in these mergers is insignificant when compared to the overall flow of funds in the U.S. and world economy. It is untrue that, as has been suggested, these borrowings represent 13% of total available credit. This is a misrepresentation of the amount of total credit available in the total banking system.

4. SOCAL's access to capital after merger

- Even though SOCAL's debt/equity level will increase and credit rating may fall, it will still maintain an investment grade rating of AA or A. SOCAL will have continued access to the worldwide capital markets to fund investment in exploration and production.

- The combined company will have sufficient cash flow to meet its debt obligations and to maintain the same level of effort in its exploration program as the two companies had prior to the merger.

5. Anti-trust Issues

- In 1982, the F.T.C. completed a study of mergers and acquisitions in the petroleum industry and concluded that the current mechanism for anti-trust review is viable, functioning, and protective of competition in all phases of the petroleum industry.

- In all recent cases of major oil combinations, the F.T.C. has closely scrutinized the proposed transaction, and has both mandated significant divestitures to ensure continued competition and has blocked any mergers that it felt would have anti-competitive effects.

- SOCAL is cooperating fully in this process, and has committed to take whatever steps are necessary to comply with the F.T.C.'s concerns.

6. Energy Prices

- The price of crude oil is set by the OPEC cartel, which controls a large portion of the world's oil reserves and production.

- Mergers of U.S. oil companies will not affect the crude price, because this is not a concentrated industry; no one company represents more than 10% of reserves or production.

- The level of regional competition in the refining and marketing sector of the petroleum industry is sufficient (and is closely reviewed by the F.T.C. in any proposed merger) so that the pump price reflects the price of crude oil plus a normal profit to the refiner/marketer. In fact, due to overcapacity in the refining sector, this "normal profit" has been marginal or negative in recent years.

- Such mergers, in fact, could reduce consumer prices due to increased efficiencies in downstream operations.

7. Impact of Proposed Legislation on Equity Markets

- The proposed legislation has already adversely impacted the value of oil company common stocks. This is an overall reduction in portfolio values of existing investors.

- A moratorium would introduce significant uncertainty into the stock market, which would be reflected in lower prices of the affected securities.

- Uncertainty and lower equity prices for oil stocks will make it harder and more expensive for oil companies, especially new and smaller companies, to attract capital in the future.

8. Impact on Shareholders

- This legislation would prevent the institutional and individual shareholders from realizing a significant premium on their shares. This will impact as many as 300,000 shareholders.

- The institutional shareholders represent insurance companies, mutual funds, charitable trusts, which collectively represent millions of individual beneficiaries or holders, who would also be deprived of the return on their investments.

9. Retroactive Impact

- After F.T.C. clearances, SOCAL is obligated to buy the Gulf shares that have been tendered, as long as legislation has not yet been enacted into law. If it subsequently is enacted and is retroactive, the result is a financial and legal nightmare. SOCAL might be forced to divest itself of Gulf's assets in a piecemeal fire sale, severely penalizing its shareholders and having an adverse impact on whatever exploration spending might have otherwise resulted.

10. Employment

- Employment statistics for the petroleum industry show that oil-related employment depends on the price of petroleum, not on merger activity.

- In the case of Gulf, employment has already been reduced by 14,000 people as part of a general response to difficult market and economic conditions.

- A merger with a healthy and well-run company can create a more viable long-term competitor and hence enhance the employment prospects for the industry.

11. Merger Makes Good Business Sense

- Increased economies, stronger financial resources, and more competition will result from the proposed merger.

- Gulf can no longer survive as an independent company - if not purchased by SOCAL, it is likely to be subject to a proxy fight and liquidated, thereby dissipating the assets of a going concern.

Impact of Mergers on Exploration and Development of Oil and Gas Reserves

1. First, the capital raised to buy an oil company doesn't disappear; it gets reinvested in the economy. Institutions, including public and private pension funds, own 30-50% of major energy companies' equity (see "Impact on Shareholders" section) , and specifically in the case of Gulf, for example, the College Retirement Equities Fund and New York State Teachers Fund own sizable positions. These institutional investors will reinvest their capital after the merger, and any sector of the economy attracts capital as long as it provides an adequate return to holders of capital.

2. More specifically, the level of expenditure for exploration and development in the U.S. is determined by the economics (the returns to investors - be they individuals, institutions, or oil companies planning their exploration budgets) of drilling for new reserves. This depends on

   i) drilling prospects
   ii) prices: set by OPEC
   iii) costs: of finding and producing new reserves
   iv) fiscal regime: windfall profits taxes, excise taxes, drilling incentives, etc.

   The exploration economics is a separate issue from the acquisition question. For many years oil in the form of energy common stocks has traded at lower prices on Wall Street than it can be obtained through exploration. Yet exploration budgets have constantly increased, in track with energy prices.

3. Graphs I and II show the strong dependence of exploratory drilling activity (as measured by the total footage of exploratory wells drilled) on oil and gas prices - as the price of the commodity increases, expenditures are increased as each new marginal barrel of oil or MCF of gas becomes economical to find

and produce. And the relationship holds for both oil drilling and gas drilling despite their fundamentally different price changes over time.

4. Similarly, in Graph III, if we examine aggregate exploration spending in the U.S. from 1974 on, we see a strong dependence on oil price. As oil prices levelled off in 1981 and began to decline, total spending dropped off for the first time.

   In Graph IV, the relationship of exploration and development investment in the U.S. to crude oil price is shown, with similar results.

5. If we compare these expenditures to oil and gas merger activity, Metzenbaum et al. would suggest there would be an inverse effect -as large amounts of capital are committed to buying companies, the outlays for exploration are supposed to fall. Yet if we look at this relationship in Graph V, we find no such evidence. The aggregate spending for oil and gas mergers peaked in 1979 and 1981, yet exploration budgets continued to rise, in parallel with the rise in oil prices. It was not until the oil price drop of 82-83 that exploration spending fell.

6. If the aggregate numbers and economics aren't convincing, then consider some major comparable cases. Much has been made of Occidental-Cities Service, which is the single exception among the large oil deals, where expenditures were cut back after the merger.

   A. When U.S. Steel acquired Marathon in January 1982, it saddled itself with $5 1/2 billion in new debt, an increase of nearly 200%. Its debt/equity ratio went from 46% to 134%. Yet, its 1982 exploration expense budget increased (from Marathon's highest level ever) over 20% to a record high $211 million.

Source: U.S. Steel 1982 Annual Report, p. 41, and Marathon Oil 1981 Annual Report, p. 42. (attached)

B. When duPont acquired Conoco in August 1981, it similarly more than quadrupled its debt liabilities by adding over $6 billion in debt. Its debt/equity ratio increased from 31% to 78%. Yet, its expenditures for U.S. exploration increased from $187MM in 1979 and $185MM in 1980 to $317MM in 1981 and $267MM in 1982.

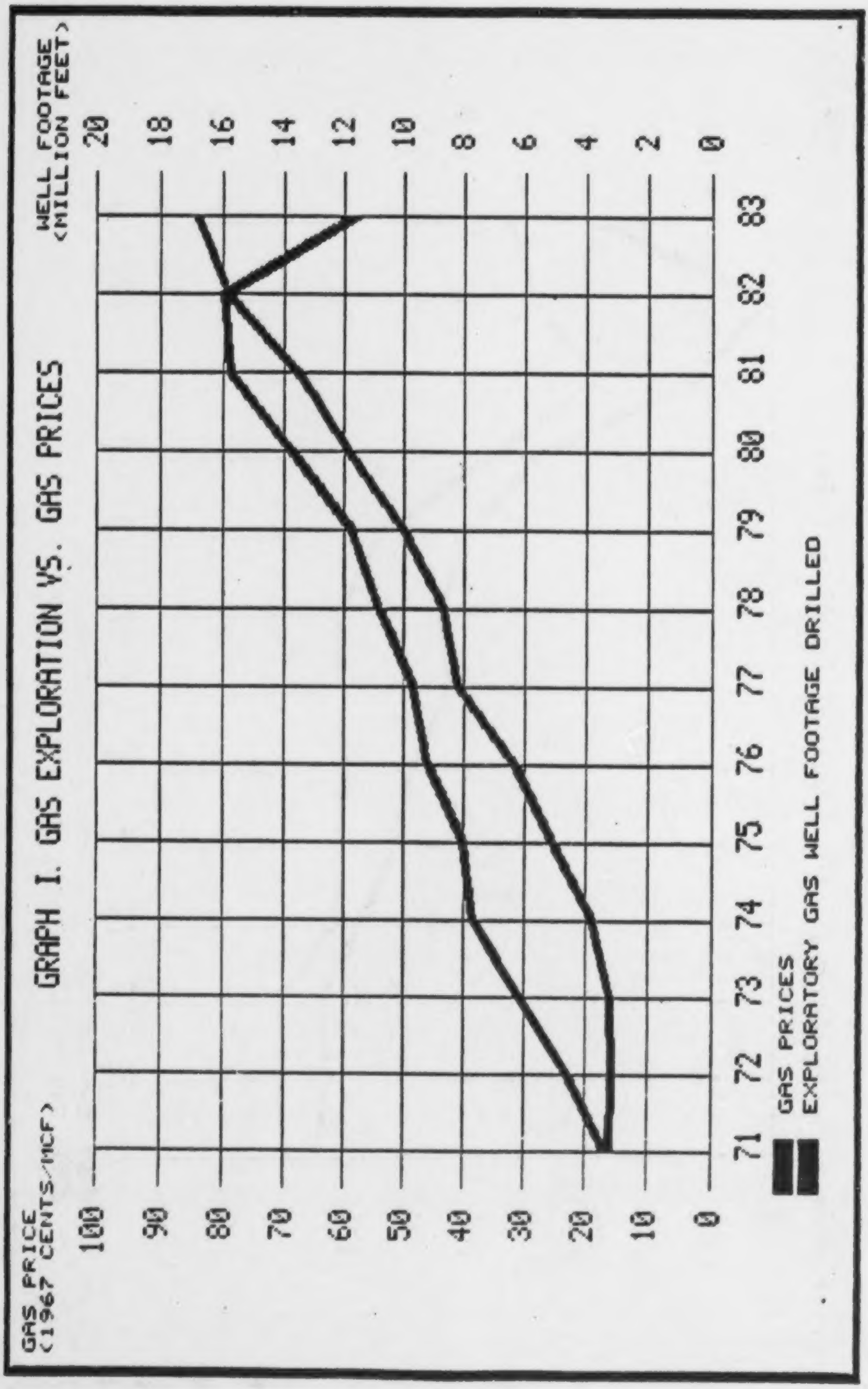
Source: duPont 1984 Business Trends, p. 6, 7. (attached)

C. Shell's acquisition of Belridge Oil in 1979 is even more convincing. Belridge had extensive reserves, especially heavy oil, but, as a private company, could not finance the huge development expenditures and didn't have access to the appropriate technology to exploit those reserves. Despite incurring a huge debt burden to complete the acquisition, Shell's development costs soared from $485MM in 1978 and $640MM in 1979 to $1,153MM in 1980 and $1,409MM in 1981. Its exploration costs increased from $369MM in 1978 and $372MM in 1979 to $499MM in 1980 and $611MM in 1981. And, most critically, the output per day from Belridge's oil fields more than doubled due to Shell's efforts and expenditures.

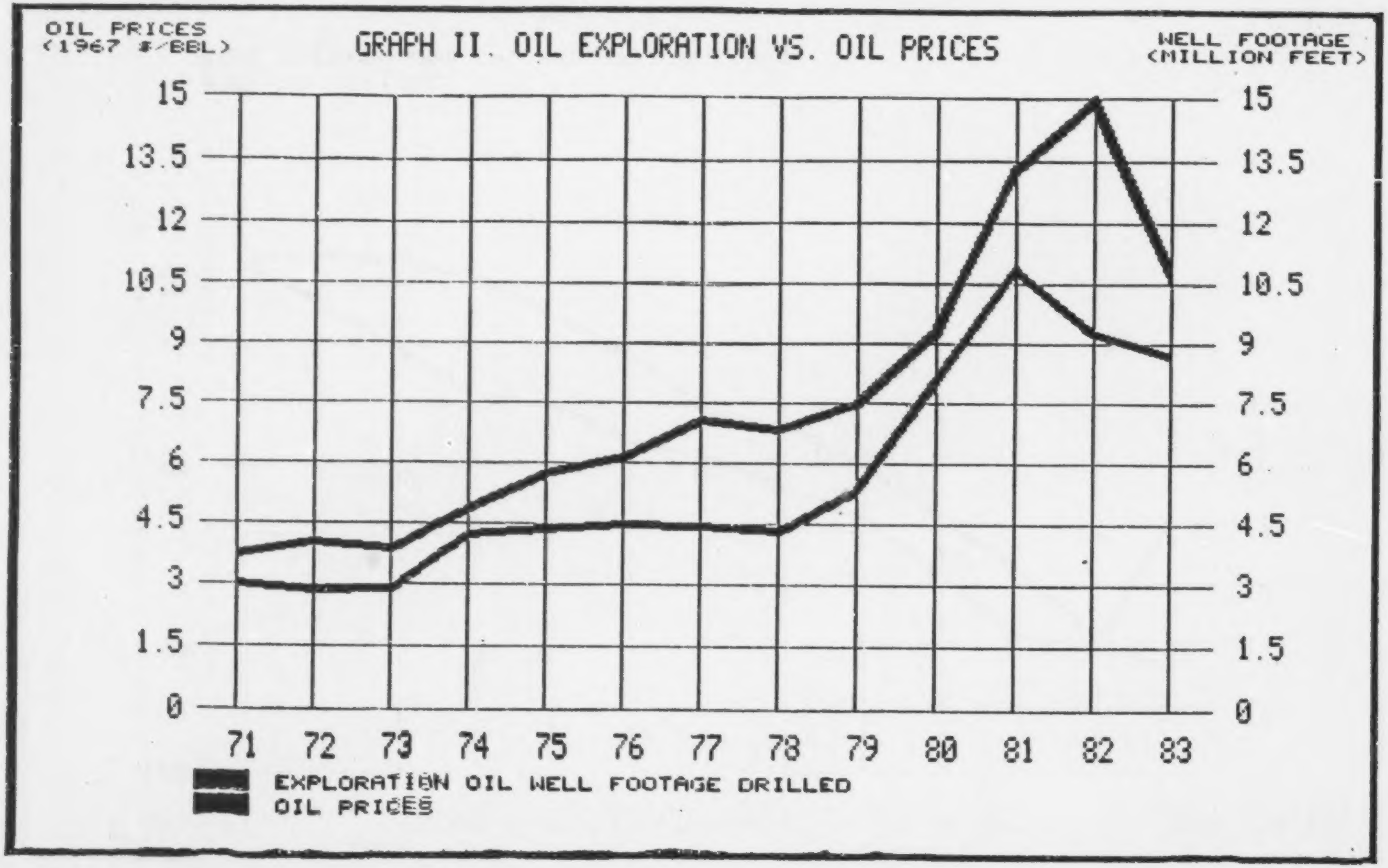
Source: Shell Oil 1981 Annual Report, p. X. and FTC Report on Mergers in the Petroleum Industry, p. 71.

7. A large portion of the new reserves and additions in the U.S. is found by independents, who play an important role in preserving our energy independence. But as easily recoverable hydrocarbons become more scarce, the exploration frontier is being pushed to more remote and costly locations. And the importance of a major find on aggregate U.S. reserves shouldn't be understated - the Alaskan North Slope find is one dramatic example, where U.S. total proved reserves increased by over 20%. And only the large, well-capitalized majors can take the risks of a nearly $1 billion investment in Mukluk, or the major efforts in the Beaufort Sea or the Outer Continental Shelf. Major exploration projects are inherently risky, and mergers can increase the ability of the resulting company to participate in the search for new energy sources.

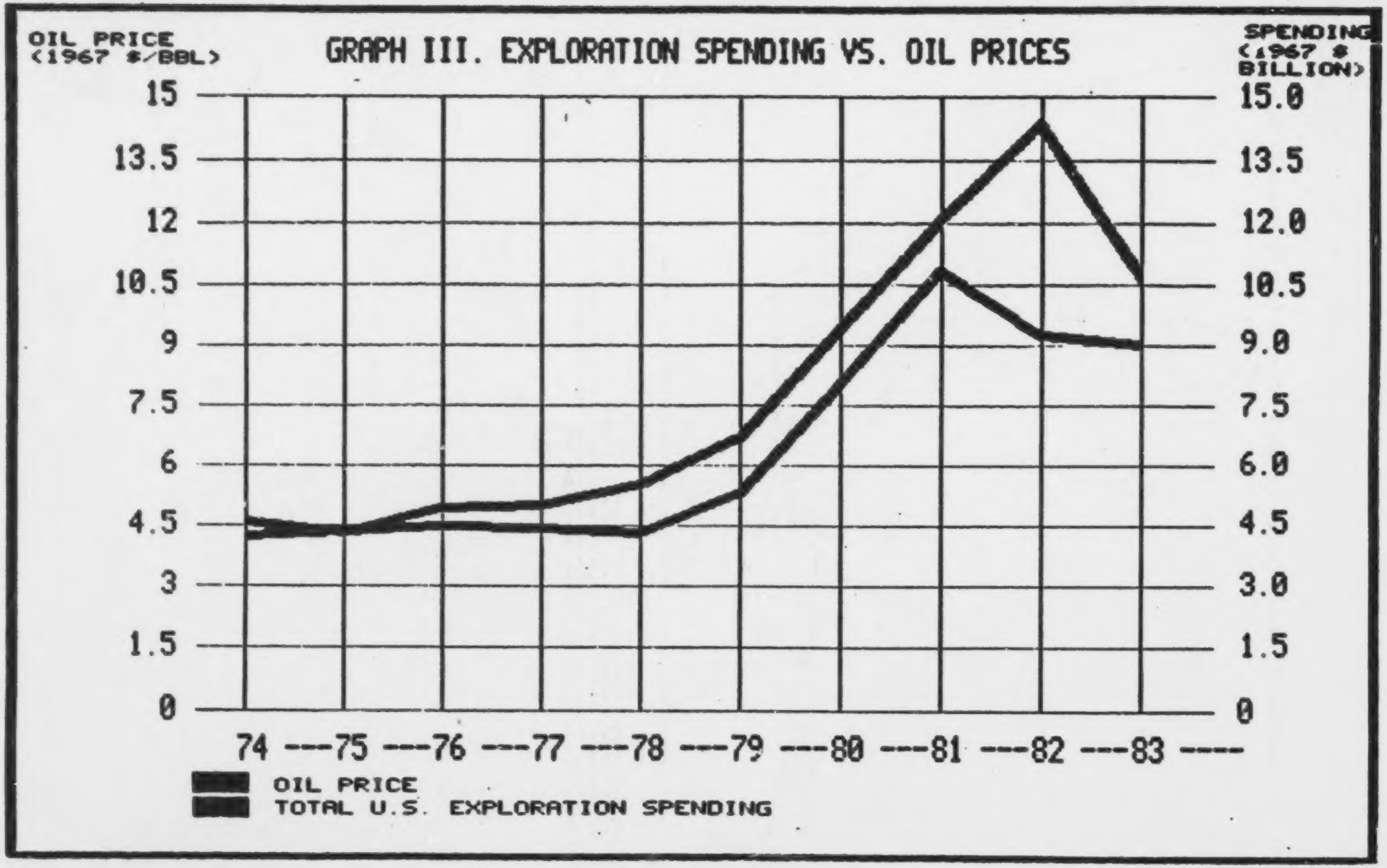
8. Similarly, the smaller independents are much more susceptible to price swings, demand shortfalls, and interest rate pressure than their better capitalized competitors. For this reason, for example, the recent slump in prices much more drastically curtailed the drilling activity of the independents than the majors. A group of strong, financially sound major oil companies, in a still unconcentrated industry, will, in the long run, be the best mechanism for continued successful discovery of oil and gas reserves.



GRAPH I. GAS EXPLORATION VS. GAS PRICES



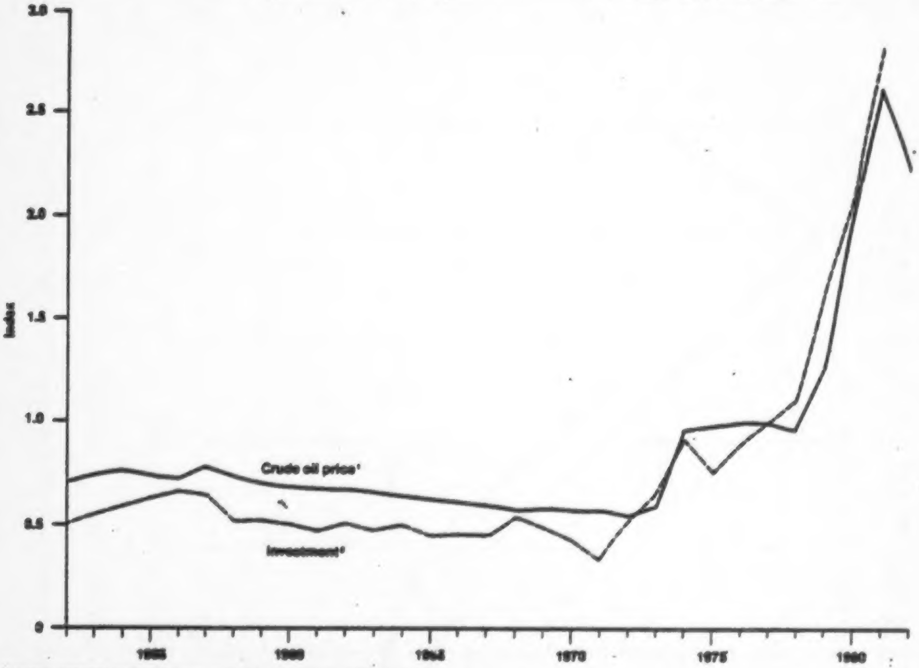
GRAPH II. OIL EXPLORATION VS. OIL PRICES



GRAPH III. EXPLORATION SPENDING VS. OIL PRICES

Graph IV.

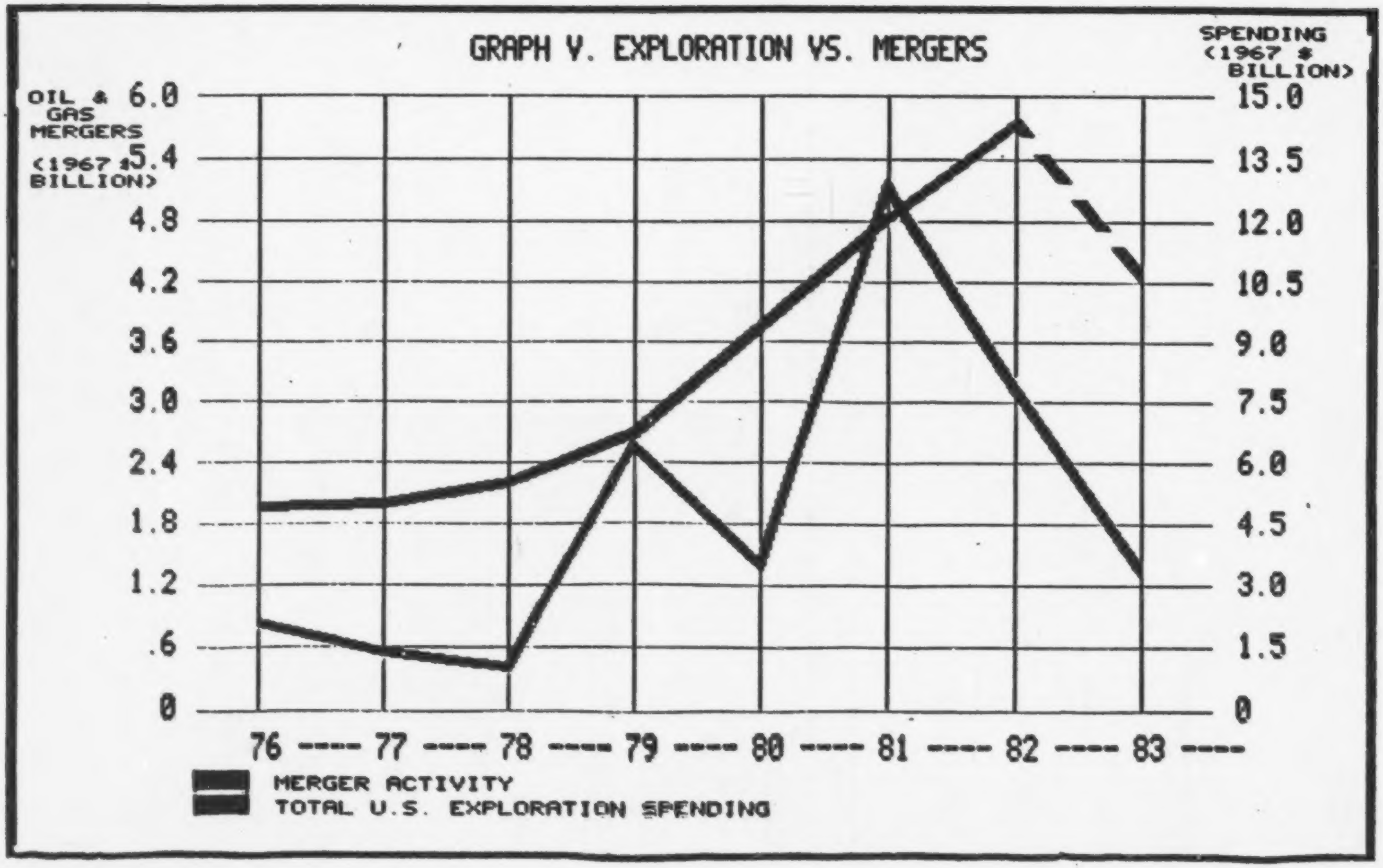
The Relationship of Exploration and Development Investment to Crude Oil Price, 1952-1982



[1] Average domestic crude oil price, normalized and deflated to 1977 base year.

[2] Domestic investment in oil and gas exploration and development, normalized and deflated to 1977 base year.

Sources: For crude oil price data, 1952-1982—Energy Information Administration, *1982 Annual Energy Review*, DOE/EIA-0384(82), Washington, D.C., 1983.
For investment data, 1952-1979—Chase Manhattan Bank, *Capital Investment in the World Petroleum Industry*, New York, 1980. For 1980-1981, U.S. Department of Commerce, Bureau of the Census, *Annual Survey of Oil and Gas*, Washington, D.C., 1981.



GRAPH V. EXPLORATION VS. MERGERS

Supplemental Petroleum and Coal Data
(continued)

Well Completions

	Development 1983	Development 1982	Exploration 1983	Exploration 1982
United States:				
Gross wells	968.0	980.0	92.0	87.0
Net wells	295.5	283.0	47.5	52.1
Oil	215.0	182.4	3.5	5.5
Gas	63.3	76.0	6.5	3.2
Dry	17.2	24.6	37.5	43.4
International:				
Gross wells	51.0	62.0	58.0	40.0
Net wells	11.9	12.3	20.6	10.4
Oil	9.4	11.0	4.0	2.8
Gas	2.0	1.0	2.5	.3
Dry	.5	.3	14.1	7.3

Petroleum and Coal Five-Year Review
(Dollars in millions)

	1983	1982	1981	1980	1979
CAPITAL EXPENDITURES(1)					
Petroleum exploration:					
United States operations:					
Acquisition of leases	$ 194.1	$ 128.9	$ 166.2	$ 127.6	$ 135.0
Wells and equipment	91.0	137.9	150.6	65.4	51.8
International operations:					
Acquisition of leases	51.5	40.2	45.9	57.9	13.0
Wells and equipment	81.9	68.6	47.3	36.8	15.8
Subtotal	**418.5**	**375.6**	**410.0**	**287.7**	**215.6**
Petroleum production:					
United States operations	216.7	396.4	500.7	380.1	242.6
International operations	385.0	408.5	326.6	305.4	275.5
Subtotal	**601.7**	**804.9**	**827.3**	**685.5**	**518.1**
Petroleum refining and natural gas processing:					
United States refining	170.1	198.4	148.0	80.9	70.2
International refining	23.2	18.0	39.1	23.4	28.0
Natural gas processing(2)	16.8	33.6	52.3	19.1	24.1
Subtotal	**210.1**	**250.0**	**239.4**	**123.4**	**123.3**
Petroleum marketing:					
United States operations	20.5	24.3	18.8	14.9	12.4
International operations	20.2	25.9	26.8	25.4	16.4
Subtotal	**40.7**	**50.2**	**45.6**	**40.3**	**28.8**
Petroleum transportation:					
United States operations	37.2	48.7	85.0	65.0	23.8
International operations	—	1.2	24.0	4.4	5.1
Subtotal	37.2	49.9	109.0	69.4	28.9
Total Petroleum	1,308.2	1,530.6	1,631.3	1,206.3	912.5
Coal:					
Coal and surface lands	26.0	50.3	87.9	28.2	[illegible]
Plant and equipment	192.2	283.3	188.1	[illegible]	[illegible]
Total Coal	218.2	333.6	276.0	199.3	182.2
Total Petroleum and Coal	$1,526.4	$1,864.2	$1,907.3	$1,405.6	$1,094.8
United States	$ 993.2	$1,271.8	$1,292.3	$ 931.9	$ 734.7

---

[1] Expenditures for property, plant and equipment and investment in affiliates. The total includes the costs of wells determined to be unsuccessful and acquisitions of [illegible]

[2] Includes transportation and storage facilities for natural gas and gas liquids.

Proceeds from Production Agreements Deferred credits and other liabilities at December 31, 1982 includes a total of $507 million in proceeds from production agreements which Marathon Oil Company has obtained in connection with the development of the following oil and gas fields:

At December 31, 1982, Marathon had $252 million outstanding, excluding current portion of $16 million, in connection with a production payment financing of the Kinsale Head gas field. A variable percentage of the proceeds from the sale of gas production is dedicated to repay the financing. The production payment is secured by the proceeds from the sale of the gas from the field and by the related assets and is non-recourse in that Marathon has not guaranteed payment or production.

Marathon also had $255 million outstanding at December 31, 1982 under the $325 million non-recourse portion of a $650 million production payment facility obtained in connection with financing the development of the South Brae Field. Under the agreement, a variable percentage of the proceeds from certain hydrocarbon sales from the field is dedicated to repay the financing. Prior to completion, up to $325 million of the production payment is secured solely by the proceeds from the sale of crude oil and natural gas liquids from the field and the related assets and is non-recourse in that Marathon has not guaranteed payment or completion of the project; the remaining portion is secured by a repurchase obligation. After completion, and subject to certain conditions, the entire production payment may be converted to non-recourse status.

Interest expense on the foregoing production payments varies based on the London Interbank Offered Rate plus a contractual margin.

25. Financial Data for Oil and Gas Producing Activities

Capitalized Costs and Allowances for Depreciation, Depletion and Amortization

(In millions)	United States	Europe	Middle East and Africa	Other Foreign	Total
As of December 31, 1982:					
Capitalized costs:					
Unproved properties	$ 332	$ —	$ 20	$36	$ 388
Proved properties	4,338	1,052	103	25	5,518
Total	4,670	1,052	123	61	5,906
Allowances for depreciation, depletion and amortization:					
Unproved properties	22	—	1	2	25
Proved properties	293	11	4	—	308
Total	315	11	5	2	333
Net capitalized costs	$4,355	$1,041	$118	$59	$5,573
Costs Incurred					
1982:					
Acquisition of properties	$ 69	$ 2	$ —	$—	$ 71
Exploration	211	33	119	45	408
Development	190	239	32	2	463
Production[(a)]	822	23	49	—	894
Depreciation, depletion and amortization	346	13	7	2	368
Net Revenue — Proved Developed Oil and Gas Reserves					
1982:					
Sales revenue[(b)]	$ 156	$ 55	$ 20	$—	$ 231
Transfer revenue[(b)]	955	—	630	—	1,585
Less foreign income taxes	—	—	(586)	—	(586)
Net revenue before U. S. income taxes	$1,111	$ 55	$ 64	$—	$1,230

(a) Production costs, in this schedule, are defined as costs of labor to operate the wells and related equipment, repairs and maintenance, materials, supplies and fuel consumed, supplies utilized in operating the wells and related equipment and facilities, windfall profit tax, property taxes, insurance, severance taxes and production administrative expenses.

(b) In the calculation of net revenue, only production costs are deducted from gross revenue. Gross revenue excludes royalties. Transfer revenue represents net revenue from intracompany sales at approximate market values. Data on foreign income taxes is provided because of significance.

Marathon Oil 1981 Annual Report

[illegible]

	United States	Canada	Europe	Middle East and Africa	Other Foreign	Total
			thousands			
COSTS INCURRED						
1981:						
Acquisition of properties	$ 171,102	$ 124	$ (178)	$ 822	$ 4,508	$ 176,378
Exploration	175,104	15,090	50,104	120,679	78,337	439,314
Development	198,528	1,792	283,693	38,576	37	522,626
Production	1,003,520	11,473	18,524	50,825	—	1,084,342
Depletion and depreciation	133,108	1,765	11,818	13,849	11	160,551
Lease impairment	47,052	753	53	316	1,245	49,419
1980:						
Acquisition of properties	$ 123,010	$ 2,761	$ —	$ 750	$ —	$ 126,521
Exploration	167,601	22,939	20,322	35,994	79,209	326,065
Development	151,300	3,508	129,466	33,757	48	318,079
Production	436,565	7,595	17,564	52,737	—	514,461
Depletion and depreciation	134,448	1,848	7,180	20,500	4	163,980
Lease impairment	21,233	497	485	58	656	22,939
1979:						
Acquisition of properties	$ 61,351	$ 1,733	$ —	$ —	$ 4,623	$ 67,707
Exploration	98,214	8,328	27,818	30,237	32,548	197,145
Development	146,776	2,691	29,629	40,558	—	219,654
Production	196,302	5,902	11,494	30,954	—	244,652
Depletion and depreciation	90,542	1,790	5,554	7,552	—	105,438
Lease impairment	38,629	759	246	113	1,548	41,295
NET REVENUES						
1981:						
Proved developed oil and gas reserves:						
Sales revenue	$ 169,900	$ 22,746	$ 43,876	$ 33,218	$ —	$ 269,740
Transfer revenue	1,052,784	—	—	614,931	—	1,667,715
Foreign income taxes	—	(8,535)	—	(604,559)	—	(613,094)
Net revenue before U.S. income taxes	$1,222,684	$ 14,211	$ 43,876	$ 43,590	$ —	$1,324,361
1980:						
Proved developed oil and gas reserves:						
Sales revenue	$ 180,515	$ 25,509	$ 31,399	$ 56,077	$ —	$ 293,500
Transfer revenue	737,930	—	—	1,071,820	—	1,809,750
Foreign income taxes	—	(8,492)	—	(1,057,491)	—	(1,065,983)
Net revenue before U.S. income taxes	$ 918,445	$ 17,017	$ 31,399	$ 70,406	$ —	$1,037,267
1979:						
Proved developed oil and gas reserves:						
Sales revenue	$ 145,900	$ 23,942	$ 10,171	$ 19,459	$ —	$ 199,472
Transfer revenue	501,467	—	—	724,315	—	1,225,782
Foreign income taxes	—	(9,102)	—	(667,181)	—	(676,283)
Net revenue before U.S. income taxes	$ 647,367	$ 14,840	$ 10,171	$ 76,593	$ —	$ 748,971

Tax Issues

1. Foregone Revenues to Government

   - According to Gulf Corp., the Socal/Gulf transaction would result in approximately $2 billion in taxes payable to the U.S. government.

   - Similarly the Mobil/Superior transaction would generate several hundred million dollars of tax revenues.

   - This is both a source of revenue, and a reduction in the amount of financing the government must obtain from the capital markets.

2. Tax Deductability of Interest

   - The argument has been made that by allowing interest deduction on borrowings to finance acquisitions, the small taxpayer is subsidizing these unproductive mergers.

   - For every dollar loaned, the interest is income to one party and expense to another, but in both cases subject to the tax laws, and hence resulting in offsetting events for the tax collector.

   - The argument that banks have a lower effective tax rate (and thus their interest expense doesn't offset the interest deduction of the oil companies' borrowings) is specious; ultimately the money that is available for the bank to lend is originating from a taxable party, whether it be in the form of CD's, time deposits (savings accounts), NOW accounts, etc.

3. Special Tax Subsidies to Oil Companies

   - Oil companies do not have special tax subsidies which encourage mergers.

- Oil companies aren't the beneficiaries of special tax subsidies; rather, to encourage exploration and production of new energy sources, several tax incentives were created.

- Thus, an oil company will have a low tax rate only to the extent it continues to invest in exploration and production.

- Further, by making large capital expenditures to upgrade refining and marketing facilities, companies like Socal have relatively low tax bills. But these incentives are the same made available to every industry and company to encourage capital formation.

- Finally, it should be noted that oil companies are among the largest (if not the largest) taxpayers of any sector of the economy. The windfall profits tax alone, according to Senator Nickles, is equal to 30% of all income taxes paid, including those by oil companies.

Overall Credit Issues

1. There has been some discussion that the recent large oil mergers or proposed mergers will use up credit in the financial markets.

   A Dow Jones news story contained remarks by Preston Martin, Vice Chairman of the Federal Reserve Board, who should be eminently able to comment on this point. This story read in part:

   > WASHINGTON - DJ - FEDERAL RESERVE BOARD VICE CHAIRMAN PRESTON MARTIN SAID LARGE CORPORATE TAKEOVERS SUCH AS THOSE CURRENTLY UNDERWAY IN THE OIL SECTOR DON'T HARM U.S. CREDIT MARKETS DESPITE THE VERY LARGE SUMS RAISED TO FINANCE THE TRANSACTIONS.
   >
   > SPEAKING TO THE NATIONAL ADVISORY COUNCIL OF THE SENATE SMALL BUSINESS COMMITTEE THE OFFICIAL SAID SUCH TAKEOVER ACTIVITY CAN RESULT IN "A GREAT SHIFT OF FUNDS" FOR THE PERIODS OF AROUND SEVEN TO TEN DAYS BUT THAT THE MONEY INVOLVED DOESN'T GO INTO A "BLACK HOLE." IN MANY CASES HE SAID IT IS SIMPLY RETURNED TO THE SAME BANK FROM WHICH IT CAME.
   >
   > MARTIN TERMED WHAT HAPPENS "A WAVE PHENOMENON" OVER SEVERAL DAYS THAT "DOESN'T REALLY TAKE CREDIT OUT OF THE ECONOMY."

2. Lief Olsen, Chairman of the Economic Policy Committee of Citibank, in a written submission to the Senate Judiciary Committee on March 15, 1984, states:

   > Standard Oil Company's borrowing of $13.2 billion from more than 60 commercial banks to purchase Gulf Oil would not increase interest rates and, even if participants in the market believed it would, the resulting rate rise would be very small and very brief. And the borrowing by SOCAL would not withhold credit from competing

borrowers. It is a financial transaction in which shareholders receive cash in exchange for their equity shares, something that happens every day as shareholders around the world buy and sell billions of dollars worth of shares in U.S. corporations. This transaction is different only in that it involves the purchase of all the shares of a single company — Gulf Oil Corporation. A $13.2 billion transaction may seem large in absolute terms but when placed in the context of the $30 trillion gross transactions undertaken in the equity market last year, it represents one twentieth of one percent. Compared with gross bank lending and investing of more than $4 trillion, it represents one third of one percent.

When it is placed in the context of net additional new credit (referred to by Metzenbaum), which last year amounted to $510 billion and this year is targeted by the Fed at $470-570 billion, it is 2.5% of that total. But it is not appropriate to look at this as a net addition to total outstanding credit, as might be the case if the borrowed money is used to acquire real new capital, whether it be brick and mortar and machinery or new automobiles and houses. The SOCAL acquisition of Gulf Oil is, instead, a purely financial transaction in which the borrowed money would pass swiftly to the shareholders of Gulf. They would then use those proceeds to buy other stocks or bonds. So given the fungibility of money, the proceeds from the Gulf purchase by SOCAL would flow back into the money markets where they would be available to finance business (emphasis added). No credit is withheld from other borrowers, and the effects on interest rates, if any, are very small and shortlived and would arise only from the illusory expectations of market participants. Furthermore, that part of the $13.2 billion received by Gulf shareholders which is paid in taxes (perhaps about $2 billion) will offset the need for an equivalent amount of borrowing by the federal government.

3. The overall size of the credit market in the U.S. and worldwide is extremely large.

- Total assets of domestically chartered commercial banking institutions were $1,969.4 billion as of December 1983.

- In addition over 60% of the lenders participating in the SOCAL loan were foreign banks. These banks had access to worldwide sources of capital amounting to over a trillion dollars.

- Therefore we can see that the size of the financing is not large in the overall context of the credit markets and that the SOCAL financing does not use up the credit capacity of the overall economy.

4. In its report, the SEC Advisory Committee on tender offers discussed the impact of takeovers on the availability and supply of credit. The Committee's report and recommendation on this topic states:

> "Finally; both the Committee and the Senate Banking Committee identified as a major issue the effect of the takeover process on the availability of credit and its allocation in the economy. On the basis of its experience and study, including a meeting with Federal Reserve Board Chairman Paul Volcker and members of his staff, the Committee has concluded that transactions involving acquisitions of control do not result in a material distortion in the credit markets, do not divert investment from new plants, do not limit consumers' ability to obtain credit and do not otherwise deplete available credit. Acquisition financing generally can be expected to have little lasting impact on the cost and availability of credit to other potential borrowers. Takeover transactions fundamentally involve a transfer of assets, not the absorption of new savings, and because the sellers of stock to an acquiring firm reinvest the proceeds, the capital is made available to others.
>
> Recommendation
>
> There is no material distortion in the credit markets resulting from control acquisition transactions, and no regulatory initiative should be undertaken to limit the availability of credit in such transactions, or to allocate credit among such transactions".

5. It is important to note that the acquiring company's choice of short term bank credit is solely because of the short time frame available to arrange the transaction. Each company, though, can retain their financial flexibility by refinancing the bank debt with both equity and alternative debt instruments and by selling other corporate assets outside the oil and gas business.

    - In Texaco's case, for example, only three weeks after the transaction approximately 20% of the bank debt was refinanced in the Eurodollar market. Further, a divestiture program is underway to further reduce the balance sheet leverage.

- Socal similarly will be examining the combined company's assets for potential divestiture candidates, and will also commence a refinancing program to strengthen their balance sheet. Chairman George Keller has stated he expects to regain a AAA credit rating in less than five years.

Socal is currently rated triple A by both Moody's and Standard & Poor's.

If Socal's rating were to drop to double A it would have access to the credit markets on terms comparable to the following oil companies:

Unocal Corp.
Phillips Petroleum
Sun Company

If Socal's rating were to drop to single A it would be comparable to the following oil companies:

Standard Oil (Ohio)
Tenneco
Diamond Shamrock
Kerr-McGee
Pennzoil

And Socal is likely to have better access to the credit markets than the following companies:

Mesa Petroleum
Louisiana Land & Expl.
Southland Royalty
Pogo Producing Co.
Murphy Oil

Overall Monetary Flow Statistics

Money supply average daily amount outstanding (seasonally adjusted)

M1	$ 518.2 billion	(Nov. 83)
M2	$2,175.7 billion	(Nov. 83)
M3	$2,587.1 billion	(Nov. 83)

Total loans and securities of all commercial banks: $1,558.8 billion (Nov. 1983)

Total assets of commercial banking institutions: $1,969.4 billion (Dec. 1983)

Demand deposits: $241.6 billion
Small denomination time deposits: $785.6 billion
Large denomination time deposits: $324.9 billion

Syndicated Credits: $139.9 billion (1983)

Source: Federal Reserve Bulletin January 1984
International Money and Capital Markets
Eurostudy 1983/84.

SOCAL's Access to Credit Markets

- SOCAL will have a higher debt to capital ratio after the merger. The debt to capital ratio will be over 40% and will probably cause a reduction in SOCAL's credit rating to a double A or perhaps a single A. However this reduction in ratings will not hinder SOCAL's access to the worldwide credit markets or preclude SOCAL from refunding its bank debt with other types of debt or other securities.

- Much has been made of SOCAL's debt to capital ratio after its acquisition of Gulf. However SOCAL will still be in much better shape financially than a large number of smaller companies who are not only more highly leveraged than SOCAL but are also smaller and do not have the stable cash flow that SOCAL has. SOCAL even after the acquisition will be in better financial shape than a large number of financially pressed independents and will certainly be in a healthy enough financial condition to fund its ongoing exploration and production plans.

- The creditworthiness of SOCAL after the acquisition and the attractiveness of lending to SOCAL can be further illustrated by the following:

  - the bank syndicated credit was oversubscribed: more banks wanted to lend to SOCAL and some banks wanted to lend more than was finally agreed on.

  - the pricing of the loan was very close to the banks' costs of funds, making the loan only marginally profitable to the banks.

- An oversubscribed syndicate and competitive price terms are hardly indicators of poor risk. Obviously the international financial community regards the Gulf acquisition as not significantly hampering SOCAL's future creditworthiness.

Anti-Trust Issues

1. FTC Report

- The FTC conducted an extensive study in 1982 of mergers and acquisitions involving large oil companies. Their general findings were:

  a. "Based upon the analysis in those sections, the Commission does not believe that prices or availability of supply have been adversely affected by the acquisitions that have occurred in the past few years. Although in absolute terms many acquisitions have been large, compared to the size of the industry they have been relatively small. This can be attributed in part to the nature of the acquisitions. The largest acquisitions directly affecting competitive conditions have involved mainly crude oil assets where the market, with some exceptions, is world-wide, and where market concentration is not high."

  b. "Increases in concentration resulting from recent large mergers have been very small for the most part, and do not appear to have endangered competition. However, despite the existence of substantial competition in most aspects of the petroleum industry, mergers of competing petroleum firms should continue to be scrutinized for anticompetitive effects in particular markets."

  c. "Based on currently available information, the Commission recommends against any legislative ban on oil company mergers. Such interference in normal market forces is unwarranted, both because there have been no significant adverse implications on the state of competition in the industry from mergers, and because mergers with significant competitive impact can be satisfactorily examined under Section 7 of the Clayton Act and the 1976 Hart-Scott-Rodino amendments to that statute."

2. Details of FTC Investigation of Key Oil Mergers

- "The FTC's investigation of the proposed Mobil/Marathon merger revealed significant potential antitrust concerns involving competition in certain "downstream" markets — those involving the wholesale and retail distribution of gasoline, home heating oil, and certain other pertroleum products. The Commission determined that these concerns were too significant to permit the merger to proceed, and filed a preliminary injunction suit to block the merger."

- "Marathon's private suit certainly played a major role in the eventual success of U.S. Steel in acquiring Marathon. The commission, however, was ready, willing, and able to litigate its preliminary injunction suit had that proven necessary to prevent the anticompetitive aspects of Mobil's proposed acquisition of Marathon."

- "The next major Commission action involving this industry occurred when Gulf Oil Company attempted to acquire Cities Service Company in mid 1982. Once again, the FTC conducted its review under the Hart-Scott-Rodino procedures, and once again the Commission determined that enforcement action was required to forestall anticompetitive consequences. Following the Commission's filing of a preliminary injunction suit, Gulf abandoned its bid to acquire Cities Service."

- "The Texaco/Getty merger followed the pattern of the prior two transactions, and the FTC once again concluded that the proposed merger raised substantial antitrust concerns warranting enforcement action. First, the merger raised concerns about competition in the manufacture and transportation of "refined light products" in the northeastern United States. Second, the merger threatened to reduce competition in the wholesale distribution of gasoline, home heating oil, and diesel fuel to retailers in the Northeast. Third, the Texaco/Getty combination raised a danger of diminished competition in transporting refined light products by pipeline into Colorado. Finally, the merger might result in the demise of independent refiners in California, reducing competition in the already moderately concentrated California refinery market."

- "The four antitrust concerns identified were serious ones. The Commission's staff of economists and lawyers, however, unanimously concluded that they could be remedied without barring the entire merger. Thus, following our standard practice in merger investigations, (the staff) entered a series of intensive negotiations with counsel for Texaco to determine whether the antitrust concerns could be eliminated. Following these negotiations, Texaco agreed to submit to an FTC order that the agency's staff of economists and attorneys unanimously agreed would remedy any possible anticompetitive harm from the merger."

3. Conclusions about FTC Procedures

- A strong review procedure to protect competition in all sectors of the industry exists.

- Despite complaints of the Reagan administration's enforcement of antitrust policy, it is clear the FTC not only closely scrutinizes oil mergers but actively demands that the mergers comply with stringent pro-competition guidelines, even going as far as blocking several large proposed mergers if those guidelines aren't met.

4. Socal/Gulf Merger

- Socal and Gulf have carefully reviewed the overlap of their businesses.

- The only potential area of concern is in certain regional refining and marketing areas.

- Socal has clearly outlined its plan to cooperate fully with the FTC and to take whatever steps are necessary to comply with FTC concerns.

5. Herfindahl/Concentration Arguments by Senator Rudman

- The Herfindahl/Hirschman index is simply a guideline that attempts to summarize the impact of a merger on competition within an industry and thus the likelihood of an FTC challenge, all based on a simple mathematical calculation.

- The general tone of that guideline is that a merger in an unconcentrated industry is unlikely to generate any problems, because even the number 1 and 2 competitors combining would still leave the overall industry unconcentrated, compared to, say, the steel industry.

- Senator Rudman misuses this fact by asserting that this guideline would allow six of the biggest oil companies to merge into one without challenge. There are two responses to this misstatement.

  a. His argument rests solely on the fact that the industry currently falls into the "least concentrated" category (with the HHI less than 1,000), so that no matter what the effect of the merger, the guideline suggests a challenge is unlikely. But actually, if any two of these large companies merged, there would immediately be HHI problems in regional refining and marketing areas, problems that automatically trigger FTC review. There is some truth to his statement, and that is in recognizing the tremendous fragmentation of this industry—that production and reserves in the U.S. are spread out amongst dozens of large companies, each one of which is a financially immense company. The complete lack of concentration in the domestic exploration and production end of the business, even if we ignore the larger global/OPEC ramifications, is such that no merger, or several mergers, can fundamentally alter the level of competition in the industry.

  b. Even more simply, an HHI calculation on Texaco/Getty surfaces no areas of "likely challenge." Yet even that merger, with one partner a relatively minor player in the downstream businesses, generated intense FTC scrutiny and resulted in a forced compliance with FTC divestiture requests.

Conclusion:

A strong anti-trust review process is in place and works extremely effectively.

Update of FTC Testimony of 3/15/84 and Table VI B-5 of the FTC Report, Pg. 156

U.S. Crude Oil, Condensate and Natural Gas Liquids Production, 1982 and Pro Forma (2)

(000 Barrels/Day)

Company	1982		Pro Forma	
	Reserves	Percent of Total	Reserves	Percent of Total
Exxon	740.0	7.3	740.0	7.3
Standard of Ohio	694.9	6.8	694.9	6.8
Atlantic Richfield	607.4	6.0	607.4	6.0
Shell	519.0	5.1	519.0	5.1
Standard of Indiana	409.0	4.0	409.0	4.0
Texaco	352.0	3.5	632.0	6.2
Standard of California	332.0	3.3	618.0	6.1
Gulf (1)	286.0	2.8	-	-
Mobil (1)	282.2	2.8	339.5	3.3
Getty	280.0	2.7	-	-
Sun	212.1	2.1	212.1	2.1
Union	162.3	1.6	162.3	1.6
Marathon (U.S. Steel)	160.1	1.6	160.1	1.6
Occidental	151.0	1.5	151.0	1.5
Phillips (1)	140.0	1.4	140.0	1.4
DuPont	136.0	1.3	136.0	1.3
Tenneco	89.0	0.9	89.1	0.9
Amerada Hess	76.5	0.8	76.5	0.8
City of Long Beach	70.0	0.7	70.0	0.7
El Paso	67.2	0.7	67.2	0.7
Union Pacific	59.4	0.6	59.4	0.6
Superior	57.3	0.6	-	-
Santa Fe	44.7	0.4	44.7	0.4
Mitchell Energy & Devel.	41.9	0.4	41.9	0.4
Louisiana Land & Expl.	41.4	0.4	41.4	0.4
Aminoil (R.J. Reynolds)	39.6	0.4	39.6	0.4
InterNorth	37.5	0.4	37.5	0.4
Pennzoil	35.1	0.3	35.1	0.3
Diamond Shamrock	33.4	0.3	33.4	0.3
Texas Oil & Gas	33.1	0.3	33.1	0.3
Others (all smaller than the top 30)	4,008.9	39.3	4,008.9	39.3
U.S. Total	10,199.0	100.0	10,199.0	100.0
Top 4	2,561.3	25.1	2,684.9	26.3
8	3,940.3	38.6	4,559.8	44.7
15	5,328.0	52.2	5,610.4	55.0
20	5,766.7	56.5	5,923.2	38.1
30	6,190.1	60.7	N.A.	N.A.
HHI (Listed Companies)		243		283

Source: FTC testimony 3/15/84 and Company Annual Reports

NOTES: (1) The FTC has incorrectly included natural gas liquids plant production for Mobil, Union, Gulf & Phillips. Appropriate adjustments hae been made.

(2) Pro forma to reflect combinations of Socal/Gulf, Texaco/Getty and Mobil/Superior.

Update of FTC Testimony of 3/15/84 and Table VI B-6 of the FTC Report, P. 157

Proven U.S. Crude Oil, Condensate and Natural Gas Liquids Reserves, 1982 and Pro Forma (1)

(Millions of Barrels)

	1982		Pro Forma (1)	
Company	Reserves	Percent of Total	Reserves	Percent of Total
Standard of Ohio	2,855.6	8.1%	2,855.6	8.1%
Exxon	2,836.0	8.1	2,836.0	8.1
Atlantic Richfield	2,561.0	7.3	2,561.0	7.3
Shell	2,200.0	6.3	2,200.0	6.3
Standard of Indiana	1,660.0	4.7	1,660.0	4.7
Getty	1,241.0	3.5	-	-
Standard of California	1,202.0	3.4	2,018.0	5.8
Texaco	1,045.0	3.0	2,286.0	6.5
Mobil	906.0	2.6	1,044.7	3.0
Gulf	816.0	2.3	-	-
Sun	691.0	2.0	691.0	2.0
Marathon (U.S. Steel)	606.3	1.7	606.3	1.7
Occidental	583.0	1.7	583.0	1.7
Union	523.0	1.5	523.0	1.5
Phillips	492.0	1.4	492.0	1.4
DuPont	350.0	1.0	350.0	1.0
Amerada Hess	260.0	0.7	260.0	0.7
Tenneco	251.7	0.7	251.7	0.7
Pennzoil	140.0	0.4	140.0	0.4
Superior	138.7	0.4	-	-
Santa Fe	138.3	0.4	138.3	0.4
Union Pacific	137.6	0.4	137.6	0.4
El Paso	136.2	0.4	136.2	0.4
Aminoil (R.J. Reynolds)	120.9	0.3	120.9	0.3
Mitchell Energy & Devel.	111.6	0.3	111.6	0.3
Southland Royalty	81.8	0.2	81.6	0.2
Texas Oil and Gas	79.3	0.2	79.3	0.2
Louisiana Land & Expl.	69.0	0.2	69.0	0.2
Enserch	61.5	0.2	61.5	0.2
Kerr-McGee	60.1	0.2	60.1	0.2
Others (all smaller than the top 30)	12,724.4	36.3	12,724.4	36.3
U.S. Total	35,079.0	100.0%	35,079.0	100.0
Top 4	10,452.6	29.8	10,538.6	30.0
8	15,600.6	44.5	17,461.3	49.8
15	20,217.9	57.6	20,966.6	59.8
20	21,358.3	60.9	21,770.4	62.1
30	22,354.6	63.7	N.A.	N.A.
HHI (Listed Companies)		308		348

Source: FTC Testimony 3/15/84 and Company Annual Reports

NOTE: (1) Pro forma to reflect combinations of Socal/Gulf, Texaco/Getty and Mobil/Superior.

Update to Table VI C-1 of the FTC Report, pgs. 184-185

Refining Concentration 1983 (1)

	PADD I (2)
CR4	44.3%
CR8	72.6%
Pro Forma (3)	
CR4	52.8%
CR8	76.2%
	PAAD II
CR4	36.5%
CR8	60.7%
Pro Forma (3)	
CR4	36.8%
CR8	61.1%
	PADD III
CR4	36.5%
CR8	53.8%
Pro Forma (3)	
CR4	41.3%
CR8	56.0%
	PADD IV
CR4	47.5%
CR8	73.8%
	PADD V
CR4	56.6%
CR8	77.8%
Pro Forma (3)	
CR4	58.4%
CR8	81.6%

Source: Oil & Gas Journal, March 21, 1983.

NOTES: (1) As of January 1, 1983.
(2) Chevron's Perth Amboy refinery, which represents 11.4% of total PADD II capacity, is currently shut down.
(3) Pro forma reflecting combination of Socal/Gulf and Texaco/Getty.

Update to Table VI C-9
Pg. 203 of the FTC Report

Market Share of Various
Groups of Refining Firms 1981 and 1982

	Refinery Runs	
	1981	1982
Top 4 firms	30.9%	29.4%
Firms outside top 4	69.1	70.6
5th - 8th ranked firms	22.0	22.4
Top 8 firms	52.9	51.8
Firms outside top 8	47.1	48.2
9th - 20th ranked firms	28.8	30.2
Top 20 firms	81.7	82.0
Firms outside top 20	18.3	18.0

	Refining Capacity	
	1981	1982
Top 4 firms	30.5%	29.9%
Firms outside top 4	69.5	70.1
5th - 8th ranked firms	19.9	19.6
Top 8 firms	50.4	49.5
Firms outside top 8	49.6	50.5
9th - 20th rnked firms	27.1	27.8
Top 20 firms	77.5	77.3
Firms outside top 20	22.5	22.7

Source: American Petroleum Institute, Market Shares and Individual Company Data for U.S. Energy Markets, Discussion Paper No. 014R (1982).

Energy Prices

- The worldwide oil price is set by the OPEC cartel, which controls a large portion of the world's production and reserves. The U.S. oil companies are price takers, and have no ability to affect the oil price.

- A merger, or several mergers, of leading U.S. oil companies would do nothing to affect the competitive level of the exploration and production business or the domestic crude price.

- The price of gasoline and refined petroleum products is set by the world crude price with a refiner/marketer margin included, to reflect a normal return on investment, or profit, to the downstream business. Competition in the refining and marketing busines is intense; the current utilization of refining capacity is only 75%, leading to weakness in prices for refined products. These profits, described above, have recently been marginal or even negative.

- In the face of the OPEC-induced price increases, a number of new companies have entered all phases of the oil industry. In exploration, production, refining and marketing of oil resources and products, the market share of the largest eight participants has been steady or decreasing over the past decade; their shares are 55% of domestic reserves, 40% of production, 54% of refining, and 50% of marketing. Today, the oil industry is considerably less concentrated than, for example, the auto industry (99%) and the steel industry (72%).

- Several of the large proposed oil mergers could adversely affect the level of competition in the downstream businesses, especially on a regional basis. But the FTC has clearly demonstrated that they closely scrutinize these aspects of any proposed merger, and take any steps necessary to prevent anti-competitive mergers and thus to leave consumer prices unaffected.

- Socal is fully prepared to take whatever steps the FTC deems necessary to ensure this occurs. Consumer prices will not increase because of these mergers.

- Finally, mergers, in fact, often reduce consumer prices by allowing efficiencies - for example, in refining (with its 75% utilization rate) and marketing. In one case, Southland was able to fully utilize an efficient refinery acquired as a result of the Occidental-Cities Service merger.

- In summary, there is no factual basis to justify unqiue restrictions on the oil industry based on a concern for concentration and price control. Indeed, the nation's experience has shown that the best way to ensure competition and lower prices is to permit the market to function freely.

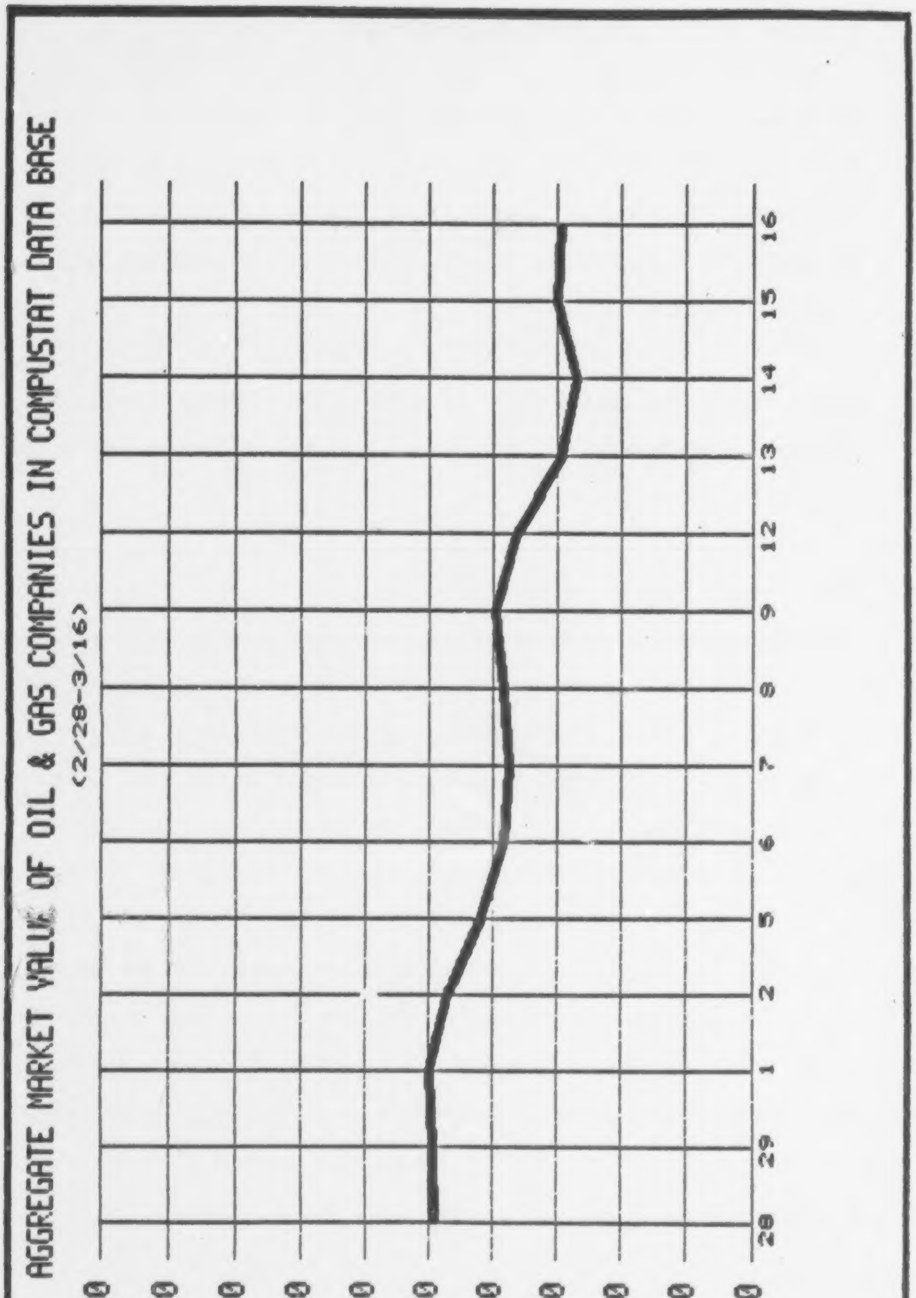
Impact on Equity Markets

1. The announcement and furor surrounding the moratorium has already impacted the equity markets.

   - The impact of a possible moratorium on oil company mergers can be seen in the graph entitiled Market Value of Oil Companies in Compustat Data Base. The market value shown has been adjusted for changes in the overall movement of the S&P index to discount the influence of factors other than the moratorium. As can be seen this moratorium has already had a depressant effect on oil industry equities, as there has already been a 4.7% decline in the aggregate value of the oil companies since Feb. 28, after adjustment for market movement. This means an aggregate loss of nearly $12 billion in the oil sector of our economy.

   - Government action which clearly drives down stock prices surely cannot be good for the companies whose stocks were driven down or for the holders of those stocks.

   - The principal holders of stock in the large companies are institutions. These institutions include pension fund, mutual fund and institutional investors. The beneficiaries of the pension funds and mutual funds are individual stockholders. Consequently the individual stockholders will suffer either directly or indirectly, through a loss in value in a pension fund for example, from this government interference in the capital markets.


AGGREGATE MARKET VALUE OF OIL & GAS COMPANIES IN COMPUSTAT DATA BASE
(2/28-3/16)
280000
274000
268000
262000
256000
250000
244000
238000
232000
226000
220000
28
29
1
2
5
6
7
8
9
12
13
14
15
16

Impact on Shareholders

- The devasting impact of the proposed legislation on the equity markets is more simply a loss of profits or a reduction in investment returns to individual shareholders. These fall in two groups - all holders of oil companies' equities and those holders specifically affected by the effect of the proposed legislation on the two pending deals.

- Gulf is held by over 250,000 stockholders. These are primarily individual and institutional shareholders, who directly hold over 85% of Gulf's shares as of 12/31/83.

- Much is made of the tremendous profits that would flow to T. Boone Pickens and to Gulf insiders if the Socal/Gulf deal is allowed to go through. In fact, Gulf insiders hold less than 1% of the total shares outstanding. Further, the 13.2% interest held by the Gulf Investor's Group is primarily held by Mesa Petroleum, and Boone Pickens and other Mesa insiders actually hold less than 20% of Mesa Petroleum. Mesa is primarily held by thousands of individual and institutional holders.

- The shareholding list for Gulf shows that significant shareholdings are reported by Gulf employees, major retirement funds and pension funds across the country, large insurance companies, and mutual funds. Simply, the Gulf-Socal merger will directly or indirectly benefit millions of ultimate beneficiaries and shareholders.

- The same argument applies across the broad spectrum of all investors in energy companies. Any legislation that interferes with the independent functioning of the capital markets, or that places restrictions, distortions, or uncertainties on a particular sector of the economy, will have the unwanted result of discouraging investment in that sector and depressing the value of equities in that sector. In this case, this would directly affect the amount of money available for drilling and exploration, precisely the opposite result the supporters of the legislation want to encourage.

Selected List of Gulf Shareholders

	# Shares	Potential Loss if Deal is Prohibited (1)
Mellon National Corp. (2)	9.7 MM	$388 MM
College Retirement Equities Fund	1.7 MM	59 MM
Texas Teachers Retirement Fund	1.0 MM	40 MM
N.Y. State Teachers Retirement Fund	.5 MM	21 MM
California Public Employees Retirement Fund	.5 MM	20 MM
Maryland State Retirement Fund	.2 MM	8 MM
Wisconsin Investment Board	.1 MM	4 MM

NOTES: (1) Assuming Gulf price returns to $40 per share.
(2) Holder of Gulf employee stock plans.

Energy Company	Institutional Holding*	Date of Report
Atlantic Richfield	52%	Feb. 17, 1984
Exxon Corp.	31%	Feb. 22, 1984
Mobil Corp.	36%	Feb. 21, 1984
Pennzoil	43%	Dec. 23, 1983
Phillips Petroleum	47%	Nov. 30, 1983
Standard Oil Co. of California	44%	Nov. 29, 1983
Standard Oil Co. of Indiana	37%	Feb. 23, 1984
Superior Oil	55-60%	Current Estimate
Texaco	29%	Jan. 18, 1984
UNOCAL	33%	Dec. 7, 1983

* S&P Stock Reports.

Retroactivity

- Socal has signed a binding contract to acquire Gulf shares. If the FTC clearance occurs, and no legislation has been enacted, Socal is required to purchase those shares that have been tendered, as long as that total exceeds 85,000,000 shares (51%). There is no condition that allows Socal to back out due to proposed or pending legislation.

- If the legislation subsequently is enacted and has a retroactivity clause back to February 28, 1984, the financial and legal implications will be enormous. Will Socal be required to divest itself of Gulf's assets? To who will it be able to sell the assets? The only possibility appears to be a piecemeal liquidation of the parts - a fire sale. Billions of dollars in vaue to Socal's shareholders could be destroyed. Further, such a sale would without a doubt result in the disappearance of whatever exploration budget might have otherwise resulted.

- The general question of the plausibility of retroactivity of such legislation is even broader. A look at the trading of Gulf stock alone since the announcement shows the magnitude of the problem.

Date	# Shares Traded	Trading Value*	Cumulative Value Since Announcement
3-6	3.694 MM	$255.8 MM	$ 255.8 MM
3-7	5.057 MM	327.4	583.2
3-8	4.655 MM	311.9	895.1
3-9	6.607 MM	430.3	1,325.4
3-12	1.842 MM	122.0	1,447.4
3-13	3.671 MM	235.4	1,682.8
3-14	2.437 MM	159.6	1,842.5
3-15	2.615 MM	173.6	2,016.0
3-16	4.399 MM	352.7	2,368.8

* Based on closing price of that day.

- Over $2 billion has traded hands on Gulf stock in only 9 days. By allowing retroactive legislation to pass, the entire functioning of the free trading market would be threatened. Shareholders would not know whether their investment decisions would later be second guessed by legislators; prices could be severely depressed as the market could lose its fundamental ability to provide liquidity to investors. Further, the effects of an indefinite moratorium on the employees, management, and investors could be disastrous.

Employment

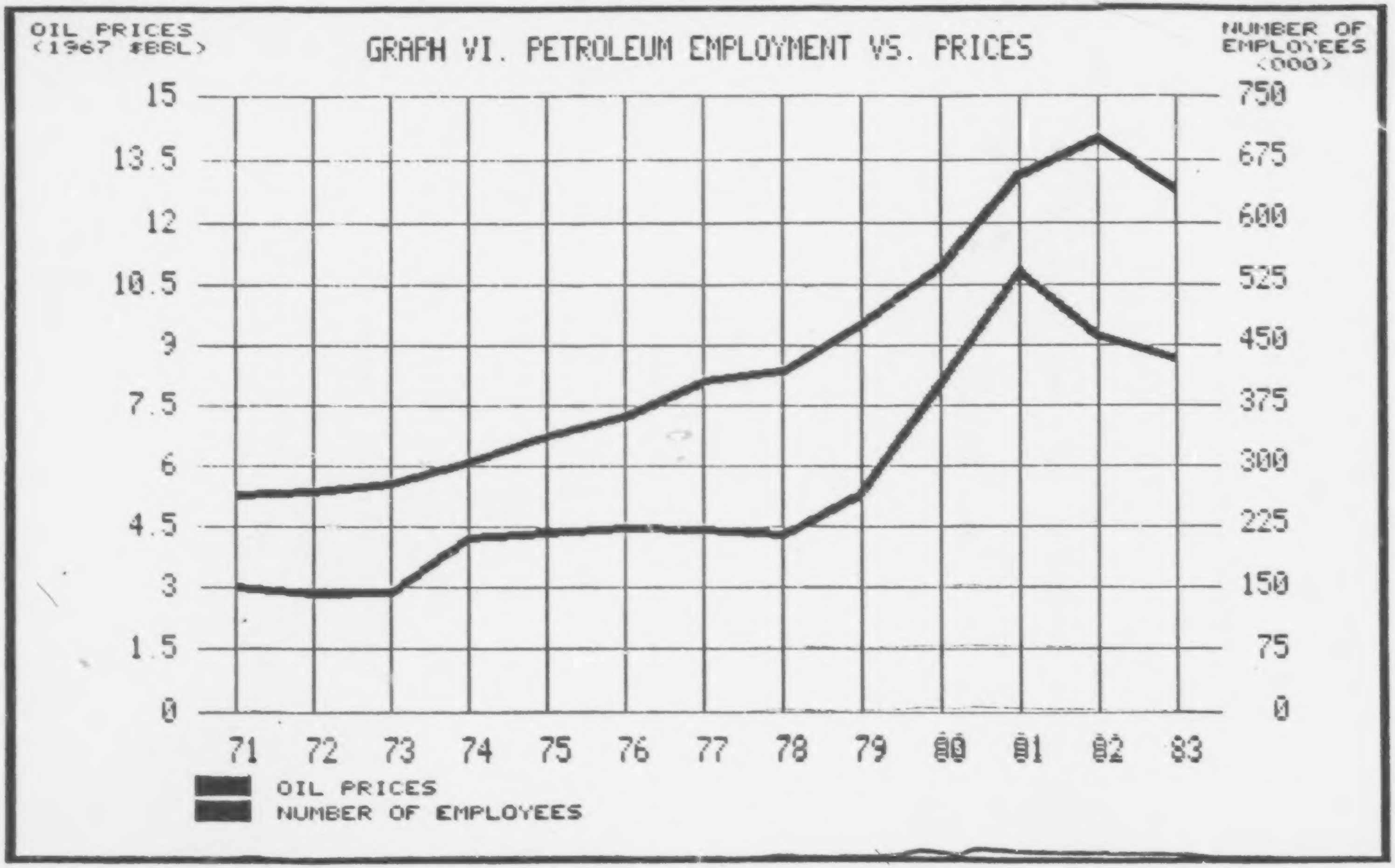
1. Sometimes mergers or acquisitions, including those in the oil industry, have been followed by the closing of certain facilities. Faced with the resulting unemployment, some have focused on the merger as a possible cause of such shutdowns. This confuses cause and effect. The truth is that pre-existing economic circumstances would have caused the plant closings in many communities whether or not a merger had taken place.

2. The availability of mergers makes it more likely that ailing plants and facilities will be revitalized. Even if the unavoidable economic realities require an acquiring corporation to terminate some facilities, the new owner is often able to strengthen the economic position of other parts of the acquired company.

3. Mergers have contributed to the long-term health of many industries, and therefore to the long-term employment prospects of those industries. Mergers have permitted more efficient operators to supersede failing businesses, and the possibility of merger has spurred the management of many companies to seek the most efficient methods of operating.

4. Employment statistics for the industry indicate that oil-related employment and facility usage depend on the international price for petroleum and not on the level of merger activity. Graph VI shows the strong dependence of petroleum industry employment on oil prices. There is, consequently, no basis for restricting oil company mergers because of a concern about possible unemployment caused by such mergers.

5. In Gulf, employment has already been reduced by 14,000 to reflect the economic conditions the industry is facing. Socal has no plans for massive lay-offs or plant closings after the merger. And where some job changes or reductions may be necessary, there are good severance and retraining programs in place.



GRAPH VI. PETROLEUM EMPLOYMENT VS. PRICES

Why Companies Merge

- The oil industry is undergoing a restructuring. Among the reasons for the restructuring are:
  - Reduced demand for oil and oil products leading to overcapacity in supply of oil.
  - Overcapacity and marginal profits in the refinery and marketing sector due to the reduction in demand for refined products.
  - The difficulty of economically replacing U.S. reserves at the current price and under current economic conditions.

- Within this setting it is natural for firms to merge or for larger, stronger firms to acquire smaller or weaker firms.

- Edward Mitchell, Professor at University of Michigan Graduate Business School, delineated reasons why firms merge in his prepared statement for the Senate Judiciary Committee hearings on March 15, 1984:

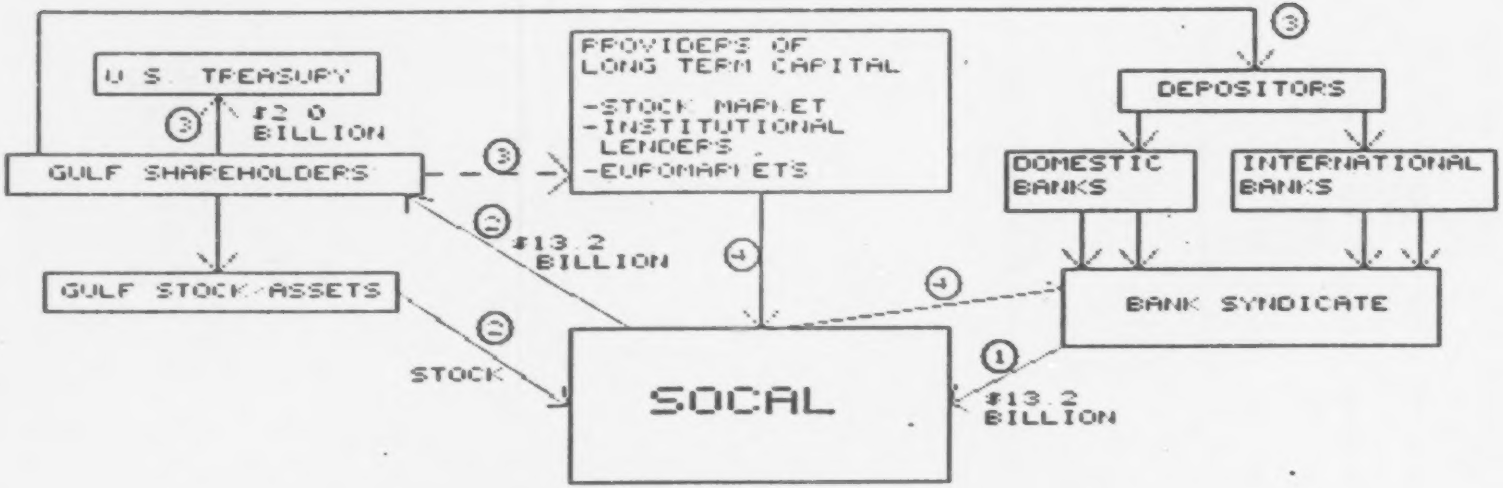
  "Mergers offer significant benefits to the economy if certain efficiencies can be gained. Potential economies from mergers include:

  - Scale economies, the larger size of the merging firms permits lower costs of production.
  - The marriage of complementary factors, e.g., a firm with strong new product R&D merges with a firm strong in marketing.
  - The rationalization of production facilities, e.g., two firms vertically integrated into the same businesses find that shutting down the weakest

units in the chain in each firm enable the merged firm to operate only the most efficient units.

- Replacement of weak management, so that assets can be employed more efficiently.
- The economical transfer of technology where the cost of transfer between firms may be prohibitive."

- Economists have performed extensive studies of the returns to stockholders of merging firms. Their investigations have repeatedly demonstrated that the gain to the stockholders (and therefore to the capital markets and our economic system) is positive from the vast majority of mergers and acquisitions. (See for example "The Market For Corporate Control: The Scientific Evidence" by Michael C. Jensen and Richard S. Ruback, Working Paper No. MERC 83-08 March, 1983.)


U.S. TREASURY
③ $2.0 BILLION
GULF SHAREHOLDERS
GULF STOCK/ASSETS
③
PROVIDERS OF LONG TERM CAPITAL
-STOCK MARKET
-INSTITUTIONAL LENDERS
-EUROMARKETS
② $13.2 BILLION
② STOCK
④
④
SOCAL
③
DEPOSITORS
DOMESTIC BANKS
INTERNATIONAL BANKS
BANK SYNDICATE
① $13.2 BILLION

① AN INTERNATIONAL BANK SYNDICATE PROVIDES $13.2 BILLION IN REVOLVING (SHORT-TERM) CREDIT TO SOCAL

② SOCAL PAYS GULF STOCKHOLDERS $13.2 BILLION FOR GULF CORP.

③ GULF SHAREHOLDERS REINVEST THEIR PROCEEDS AFTER PAYING TAXES

④ SOCAL REFINANCES SHORT-TERM DEBT VIA MULTIPLE LONG-TERM VEHICLES

WRITTEN TESTIMONY OF ALAN C. LERNER

SENIOR VICE PRESIDENT, BANKERS TRUST COMPANY

BEFORE THE
SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
OF THE
ENERGY AND NATURAL RESOURCES COMMITTEE
OF THE
UNITED STATES SENATE

APRIL 10, 1984

4-16-84

My name is Alan C. Lerner. I am a Senior Vice President and Financial Economist of Bankers Trust Company of New York. My written statement discusses the impact of mergers on the debt markets.

Bank financing to support merger activity in 1983 and 1984 has had a minor overall effect on the credit markets and on the level of interest rates, in my view. Bank and credit-market resources required to consummate even the largest mergers are not burdensome in relationship to total credit demands in the U.S. economy. This is especially true in light of the global nature of the financial marketplace and the fact that most industrial countries are not yet experiencing a strong demand for funds at this point in their respective economic cycles.

The dollar value of all mergers and acquisitions last year was about $75 billion, according to W.T. Grimm & Co., a firm which specializes in mergers. By way of contrast, outstanding bank loans to business exceed $400 billion and non-financial companies have more than $50 billion of commercial paper outstanding. It should be pointed out that not all of the bank commitments in merger situations actually become loans. There is a growing trend toward acquisition through an exchange of stock, or through terms involving a combination of stock and cash. This means of acquiring another firm can be implemented more easily when the stock market is rising, or is not severely depressed, and the increase in share values during 1982-83 has fostered stock or stock-and-cash transactions. Mergers involving cash only have gone from 55% of the total in 1979 to just 25%-30% in 1983, according to W.T. Grimm.

Obviously there has been a major amount of merger activity in 1983 and early in 1984. Some of these larger acquisitions have a short-term impact on certain banks and on the money markets when there are actual takedowns of loan commitments. Market psychology can be affected when loans are made. Almost all of these larger commitments and loans, incidentally, are made by large banks in New York City. These banks experienced weak loan growth throughout 1983, as is customary in the early stages of an economic recovery. Only now are they beginning to see an upturn. New York banks and other large banks around the world have been eager to book business in a slack period, as reflected by the relatively narrow price margins attached to some of the very large oil-industry financings. Regional and smaller banks, on the other hand, have witnessed brisk credit demands for more than a year now, and generally continue to do the bulk of their commercial business with traditional local business customers. The table below illustrates this.

OUTSTANDING U.S. BANK LOANS TO BUSINESS
($ Billions)

	Dec. 82-Dec. 83	2 Months '84
Large New York City Banks...........	- 3.4	1.1
Large Banks Outside New York City...	6.4	6.1
Large Foreign Banks.................	0.	1.5
Small Banks.........................	18.4	n.a.

Some observers have attributed the recent increase in the Prime Rate to the oil merger activity. This is a naive reaction. The Prime Rate is a lagging interest rate. History has shown that it is changed after the cost of funds for the banking system changes and not before. The recent rise in the general level of interest rates is due to a number of forces, which have little, if anything, to do with merger activity. Economic activity in the first quarter increased sharply. This brought fears that an overheated economy with rising inflation is not far behind. This fear combined with huge U.S. Government financing needs was responsible for the rise in interest rates.

As I noted earlier, U.S. banks are not the only alternative for acquisition-minded borrowers. The very large Eurodollar market also is a source of funds. That took place during the merger boom of 1981, and it is occurring again. About 70% of the net new public Eurocurrency credits announced during the first quarter of 1984 were slated for borrowers based in the United States, and some of this was tied to mergers.

When large merger-related loans are booked, the funds do not escape from our financial system. When stock is purchased in an acquisition, the former owner of those shares can deposit his funds in the banking system, or reinvest in U.S. Treasury securities, or in the stock market, for example. The acquiring firm also normally would remove the short-term debt from its books as soon as this is practical, through a longer-term bond issue, or a stock offering, or both.

It may be useful to focus on both the shorter-run and on the longer-term effects of large amounts of borrowing for mergers. As

I have indicated, there could be a very short-term market impact over the period when large loans are made. But the impact lessens as the funds are reinvested by the stockholders and reflows into the financial marketplace.

Bank loans for the purpose of effecting a merger should not be viewed differently from other types of credit extension to business. In making these loans, banks are fulfilling their role as financial intermediaries. If the mergers have the effect that the participants aimed for, then our economy will be that much more efficient. If not, the marketplace will exact a penalty. The issue which should be of concern to the Congress and to our other policy-makers, I believe, is that growth of all private credit demands accelerates as the economic recovery matures. Merger borrowing will be only a minor component of this upsurge. It will become more difficult as time goes on for private borrowers to compete with the government. Federal spending and borrowing remains out of control with $160 billion or more of borrowing on tap this fiscal year, in our estimate. More importantly, very heavy deficit financing will be the order of the day into the foreseeable future. This, more than any other factor, has led to widespread disillusionment and higher interest rates in our financial markets.

TESTIMONY OF THOMAS J. CAMPBELL
SUBCOMMITEE OF ENERGY AND MINERAL RESOURCES, COMMITTEE ON ENERGY AND NATRUAL RESOURCES
U.S. SENATE
APRIL 10, 1984

CHAIRMAN McCLURE AND SENATORS:

I am grateful for the honor of submitting testimony to your committee. Permit me to commence with a word of background. From October, 1981 to April, 1983, I was the Director of the Bureau of Competition at the Federal Trade Commission. During this time, the Federal Trade Commission, and the Bureau I directed, considered the proposed acquisition of Marathon Oil Co. by Mobil Oil Corp., the eventual acquisition of Marathon by United States Steel, the proposed acquisition of Cities Service by Gulf, and the eventual acquisition of Cities Service by Occidental Petroleum. At the time, these were the second and third largest mergers in American history.

Presently, I teach courses in advanced antitrust, business law, and economics at Stanford Law School. I hold a J.D., magna cum laude, from Harvard Law School, and a Ph.D. in economics from the University of Chicago. I have been a law clerk to Mr. Justice White of the U.S. Supreme Court, a White House Fellow in the office of the Chief of Staff at the White House in the Carter Administration, and Executive Assitant to the Deputy Attorney General Edward C. Schmults. For two years, I practiced law in Chicago, where I also taught economics.

I have no personal financial interest in the outcome of any of the oil mergers under discussion. I have not been retained by any of the parties or their agents. And I am a private citizen, with no connection to any of the antitrust enforcement agencies except my past experience.

There are two main areas of my testimony. First, I would like to provide my view of the antitrust and related competitive issues posed by large mergers in the oil industry. My conclusion is that serious anticompetitive harm is not likely to occur, and that the present enforcement scheme is quite adequate to protect the consumers' interests. But this is not to say that these mergers reflect an entirely healthy state of U.S. business climate and economy. My second topic will be to address some of the serious concerns brought to light by these mergers, that may well require legislative attention.

As a point of departure, I would like to address S.2362, a proposal for a 6 month moratorium on mineral leases for any energy company engaged in a large scale merger. I must advise that I do not favor this approach. It is fundamental that America's energy resources be developed by those concerns most efficient in doing so. Normally, we can expect the process of auctioning off government lease rights to guarantee such a result. The companies with the best technology to develop the maximum amount of natural resource per dollar invested will also be able to make the highest bid. When we impose a moratorium on such a process, we will necessarily cause energy resources to be auctioned off to the next highest bidder; but this means companies that are less efficient at developing the resources. The loss is not only in lower auction-determined lease fees to the United States Treasury, the loss is also that firms who are less sure of their ability to develop the resources will be entrusted with that task.

With this as the cost, it is fair to ask what is the intended gain from the proposal. There appears to be only one objective: to deter the major oil mergers that have been taking place. For reasons that I develop below, I favor a slowing down of mergers in this area. I believe that they are motivated predominantly for tax reasons, with no apparent efficiencies. But there is a much more tailored means of imposing exactly the kind of inhibition on this process that is necessary to insure that America continues to develop its energy resources. The approach of S.2362 is an unstructured response, with potential for being quite costly in precisely the most harmful way: inhibiting the optimal development of energy resources.

Oil companies are not at fault for merging. They are responding to tax incentives created by our government. And, with appropriate divestitures, they will likely not violate the antitrust laws. Hence, it is inappropriate to attempt to discipline them through the route of S.2362. This is not to say that the tax incentives that presently exist are correct, however. They are dangerous, and must be changed.

I. ANTITRUST ISSUES

There has been some criticism of the Administration's antitrust enforcement efforts in the oil area. I am impatient with such criticism not only because of my personal knowledge of its inaccuracy, but because it diverts attention from the truly important areas of concern which I will address in the second part of my testimony. In brief, there are serious causes for concern in any oil merger of the sizes under discussion, but there is no reason to believe that the present enforcement agencies are inadequate to address those causes for concern. And even if they were, our antitrust laws provide for private parties to bring suit in their own right. This is precisely what happened when Mobil attempted to acquire Marathon against Marathon's desire. Marathon obtained a permanent injunction against the acquisition in federal court. The Federal Trade Commission also issued a complaint against the merger; but even if it hadn't, it is fair to conclude that the federal courts would have stopped the merger on the insistence of Marathon.

In analyzing an oil company merger from an antitrust perspective, several different markets must be analyzed, tracing the production of crude oil from the ground, through the refining process, through pipelines and storage terminals, and to the ultimate gas station or final consumer. At each stage, it is appropriate to ask whether the combination of the firms in question will lead to an enhanced ability to lift the price of the product, either acting alone or in concert with other firms. The answer will frequently depend upon appropriately defining the relevant geographic and product market, for only then can we determine whether the merger partners will be able to lift price.

The SOCAL-Gulf combination will control 6.1% of the United States crude and natural gas production. Mobil-Superior will control 3.3%, and Texaco-Getty 6.2%. Each of these percentages is dramatically below the danger level any economist would perceive from the perspective of ability to influence price. The same conclusion follows from a comparison of the proven reserves controlled by each of these companies: SOCAL-Gulf would have 5.8% of the United States figure, Mobil-Superior would have 3.0%, Texaco-Getty would have 6.5%. The percentages are even lower when the entire world is considered.

As we move into refining capacity, pipeline, and terminal facilities, the prospect of enhanced market power becomes more realistic. The merging parties are obliged to provide the FTC with detailed information on the refineries owned by each, and the share of pipelines and terminal facilities under each of their control. It is possible that in some regional market, one of these companies will, by reason of the merger, acquire a percentage share of capacity enabling it to engage in short-run price-raising behavior. I particularly point to pipeline as a potential area for such attention, since most of the major pipelines are run as joint ventures between the major users of the pipeline, and some allow veto power over expansion of the pipeline capacity to a certain percentage of control far less than 50%. Thus, it is important for the FTC to consider whether, as a result of the merger, any of these companies has a motive (by reason of favorable location of its refineries, for instance) to deny to other companies using the pipeline a requested expansion of their shipments, or of the pipeline's total capacity. The voting arrangements of each of the pipelines must be studied carefully, and steps taken to prevent such abuse.

Finally, the gasoline distribution system comes to the gas station or end user. Again, it is possible that the combination of two companies will enhance their power within a certain geographical region to lift prices at the pump. Whereas any such power is likely to persist only for a short time (until other companies enter the relevant market and compete), it is appropriate for antitrust enforcement agencies to be concerned with even the short-run harm to consumers, and spin-offs of gasoline retailing facilities might be required. Viewing the three transactions from published data, it appears there may be several geographic areas in which such spin-offs should occur. In Maine, Georgia, Kentucky, and Arizona, for example, the combination of SOCAL and Gulf will result in concentrations in excess of 20% in retail distribution, although the number for the entire United States is only 10.6%. Mobil and Superior do not pose such problems because of the absence of Superior distribution outlets. Texaco and Getty appear to pose some problem only in Delaware, where the combined share of stations sums to 19.8%.

The 1982 Justice Department Merger Guidelines have received wide approval for their use of percentage market shares as guides to the possibility of anticompetitive mergers. These guidelines replaced the 1968 version, which had been discredited even by their author, Professor Turner, as no longer realistic. However, it is useful to note that even under the more stringent 1968 guidelines, the combinations of market shares such as are involved here would be presumptively lawful. Individual geographical areas, pipeline ownership percentages, storage and refining facilities might present difficulties, but the percentage shares of crude oil reserves and proven reserves do not approach the 5% and 5% (combining to 10%) standard of the most stringent guidelines to be applied in this context.

My conclusion is that antitrust problems are not likely to be severe with any of these mergers. The companies have expressed a willingness to spin off those assets in particular markets that might cause difficulty. Even were the antitrust agencies to do less than fully vindicate the interests of the American consumer, our laws provide for private antitrust enforcement. It is inaccurate, therefore, either to conclude that lax antitrust enforcement has prompted this round of mergers, or to suggest that a different Administration would stop these mergers on antitrust grounds.

It is also dangerous. Dangerous, because such attention diverts attention from the truly critical issues pointed up by the recent oil merger activity.

II. THE CRITICAL ISSUES: SHORT TERM HORIZONS, SERVILITY TO OPEC, AND ENERGY INDEPENDENCE

The fundamental reason for the recent oil mergers, including those which I personally reviewed as Director of the Bureau of Competition, is related to tax advantages and corporate control. Quite simply, crude oil is always worth more to an acquirer than it is to a company which has acquired it. This is because the acquired company has in most instances fully depreciated its cost in acquiring crude petroleum, and taken full advantage of the oil depletion allowance. A newly acquiring company, however, can step up the basis of the oil that it purchases, and commence depreciation anew. Hence, there is nothing that a present owner of old reserves can do to value those reserves as highly as would an outsider. It should be noted that the Windfall Profits Tax only aggravates this factor, since it taxes old oil at a much higher rate when it is eventually sold than new oil.

In Mobil's bid for Marathon, and in U.S. Steel's eventual successful acquisition of Marathon, more than one quarter of the premium above market price for Marathon stock was directly attributable to these tax advantages. That is to say, Marathon's oil was worth substantially less to Marathon than it was to any potential acquirer, courtesy of the U.S. tax laws. It is no wonder that take-over activity resulted, and continues, in the oil industry. See "Mergers in the Petroleum Industry," Report of the Federal Trade Commission (1982), at p. 83.

There is no necessary harm from this situation, unless acquirers are noticeably less competent managers than acquired firms. There is some cost paid out to attorneys and investment brokers, but this does not figure prominently given the size of the transactions involved. I hasten to add that there is no necessary implication that acquirers are more efficient, either. The tax consequences lead them to make their bids for the large part. Of course, there have been occasions where an acquirer can develop crude petroleum reserves more efficiently than their present owner; Shell's acquisition of the reserves of Belridge Oil in 1979 would be one such example. But there are also cases where one really doubts the ability of a non-oil company acquirer to manage an oil company better than oil company had been managed: U.S. Steel's stewardship of Cities Service springs to mind. But in general, I know of no reason to expect improved or worsened efficiency of management, exploration, and development because of mergers in the oil industries.

The problem, rather, stems with an inherent bias in the present system favoring short term horizons. Given this built-in tax advantage, as soon as a firm has held oil reserves for a number of years and has begun to depreciate them for tax purposes, another firm can offer more for those assets since they are worth more to the other firm. In order to avoid such a take-over, managers must convince their shareholders in a very short time-frame that they have been successful entrepreneurs, and control should remain in their hands. The choice will soon become one between any long-run plan for development of oil resources and the latest bid, in ready cash, from a tender offeror. In a perfect world, some investors might resist the allure of an immediate gain, expressing confidence in the ability of the incumbent management to improve share values in the long haul. But it is too much to expect that a majority, consistently, will do so. And the problem is exacerbated by the large holdings of stock by fiduciaries for pension and other trust funds. Under ERISA, such trustees have no choice but to accept the immediate cash return as a safer investment for their beneficiaries, as against the ephemeral prospect of eventual improvement in share value.

The combination of federal corporate and windfall tax laws, ERISA, and the large institutional holdings of oil stocks has been unmistakably to favor the short-run liquidator over the long-run planner. Gulf did not want to be acquired. It had to be; either by an outsider or in a proxy fight. Texaco recently acquired 9.9% of its own stock; not because that was the best investment around, but because the Bass brothers' holdings presented too real a toehold for a potential tender offer. Warner has recently bought out Murdoch's holdings in its company for the same reason. There is no sector of the stock market immune from such conduct. But in oil, the built-in advantage to any acquirer from the tax perspectives makes this phenomenon take on epidemic proportions.

And this is particularly unfortunate, for in petroleum, our country needs long-range planning more than in most other industries. Replacement of hydrocarbons has been far less than their depletion, and depressed oil and natural gas prices ensure that exploration will persist at a low rate. The manager with foresight might anticipate the day when OPEC is again able to restrict supplies and lift price; but if he dares to act on his vision at the expense of immediate earnings, a tender offeror will materialize.

The solutions to the fundamental problems whose symptoms are seen in the recent mergers, are two-fold. First, tax incentives must be structured so as not to penalize the long-range planner. In the petroleum industry, one way for this to be accomplished is to tax the tendering shareholders proportionate to the share of their gain due to the appreciated value of their companies' petroleum reserves. At present, long term shareholders pay only a maximum 20% long term capital gain, whereas the windfall profit tax to be paid by their company if it sold its oil reserves would be 70% of the difference between market price and an inflation adjusted 12.81 dollar level. Such a step would place shareholders in the same position Congress intended for oil companies; and this is appropriate since, in a tender offer, it is the shareholders who are "selling" their company's crude oil reserves. Additionally, ERISA ought to be amended to permit a fiduciary to reject a tender offer that promises an immediate profit in favor of a longer-range investment approach.

In the broader sense, additional tax incentives for corporations to invest in energy exploration and research should be contemplated. The Synfuels Corporation was intended to promote such research, yet with an 88 billion dollar authorization, it has provided only 120 million in loan guarantees. Nothing is gained by railing against the oil companies for not exploring for new petroleum when the market tells them it is inefficient to do so, and our tax laws encourage them to acquire from each other. The more constructive approach is to recognize that this may well be a case of an economic externality: where the society as a whole values something more than any individual producer. That "something" here is energy independence; and it is worth a heavier investment than present market incentives provide.

One final aspect of OPEC's behavior must not be forgotten in this discussion. In the grim experiences of the early 1970's, it became apparent that the American oil companies who were part of the ARAMCO group were tempted to behave in ways supportive of the OPEC cartel, even at a short-term cost to themselves. Mobil, SOCAL, Exxon, and Texaco were obliged to purchase more expensive petroleum from members of OPEC being subsidized by the other members, even though cheaper petroleum was available. It may be assumed that these companies acted in this way because the alternative was more serious for their shareholders; namely, a termination or loss of advantage under their joint venture with OPEC member countries in ARAMCO.

To the extent consistent with the long-range diplomatic interests of the United States, such conduct should be discouraged. Cartels like OPEC persist longer through the acquiescence of those who should be most vigorous in challenging their straglehold of supply. The American people should be warned that OPEC is not necessarily dead, that the time may come when an embargo on oil to the United States is again imposed, whether through economic design or in connection with the political turmoil in the Middle East and Persian Gulf. And when that time comes, we must make every effort to insure that our non-OPEC supplies are in the hands of those who will act in the most independent fashion possible. To this end, an increase in America's strategic reserve of petroleum, and the active scrutiny of any acquisition of a non-ARAMCO partner by an ARAMCO partner should be pursued. As such considerations go beyond the ordinary ambit of antitrust, however, the review should be undertaken with the assistance of those arms of our government most able to shed light on the behavior of such petroleum companies in connection with OPEC partners.

I do not urge that any of the present mergers be held up for the adoption of these proposals, however; principally because these mergers do not represent harmful events in themselves. What would be harmful, rather, would be to change the rules of the marketplace in a post-hoc fashion, and effect investment decisions made on the basis of what the law was perceived to be. But this is no excuse for failing to commence consideration of the legislative changes that are already long overdue.

I conclude by applauding this committee, and its Chairman, Senator McClure, for having the foresight to address the real problems that underlie the present trend in energy mergers. It is easy to focus on the mergers themselves, and make accusations of lax antitrust enforcement. But it is also irresponsible to do so, while the truly fundamental concerns continue unaddressed. This committee has set out on the right course in addressing those fundamental concerns.

Professor Thomas J. Campbell
Stanford Law School
Stanford, California 94305
(415) 497-3835

Statement by
Richard L. O'Shields, Chairman
Panhandle Eastern Corporation
In Re - S2362

Subcommittee on Energy and Mineral Resources
Committee on Energy
United States Senate

April 6, 1984

Mr. Chairman and members of the Committee. My name is Richard L. O'Shields. This statement is submitted in my capacity as Chairman of Panhandle Eastern Corporation, a holding company whose subsidiaries are engaged in the development of energy resources.

Our principal business activity involves the interstate transmission of natural gas which is performed by Panhandle Eastern Pipe Line Company and Trunkline Gas Company. Additionally other subsidiaries are engaged in oil and gas exploration and production, contract well drilling domestically and overseas and in the mining and marketing of coal.

Our pipelines supply natural gas at wholesale to 130 investor-owned and municipal gas systems operating in 12 states. Our primary market involves large portions of Michigan, Ohio, Indiana, Illinois and Missouri. During 1983, our pipeline systems delivered seven percent of the natural gas transported in interstate commerce. This volume served the gas energy needs of seven percent of the consumers of the United States.

Each of these groups is continuously involved in transactions involving Federal mineral lands, and, in particular, rights-of-way and/or leases over such lands. As currently drafted, S2362 would constitute Panhandle Eastern a "substantial energy reserve holder" because the Company's exploration and production subsidiaries have an interest in ten million barrels or more of relevant energy reserves. This legislation, therefore, is a matter of serious concern to us.

As we understand it, the purpose of the Bill, ultimately, is to define and prohibit certain classes of merger activity in the energy sector of the economy. The immediate -- and permanent -- effect of the measure, however, is not limited by definitions and is not confined to those classes of activity considered to be contrary to the common good. If a substantial energy reserve holder is found at any time in the future to have been party to "merger" activity during the proscribed time period, new business on Federal lands will be foreclosed to it forever, regardless of whether the merger activity involved is ultimately included among those prohibited.

The unfairness and unsoundness of this result is readily apparent.

The definition of merger, for instance, is overbroad including normal reorganizations as well as acquisitions. Under this standard, the dividending of assets to a newly created parent corporation would constitute a merger, as would a true merger of two or more wholly-owned subsidiaries of a single holding company. Each of these transactions is a normal business activity and neither is among those ultimately targeted.

The definition of merger would, also, literally include the acquisition by an employer of the majority of the assets of an employee (i.e., the employer's purchase of its employee's residence). By this standard, routine incidents of employee transfer could perpetually deprive a corporation of the right to transact business on Federal lands.

Further, the "mergers" proscribed include divestitures as well as acquisitions, so long as one party to the transaction is a "substantial energy reserve holder." For example, an oil company could not generate cash for energy exploration by sale of a non-energy subsidiary, unless it was willing to trigger the Bill's perpetual prohibition.

The definition of "substantial energy reserve holder" is not without problems. The trust department of almost any bank, royalty owners in pooled acreage, some state university systems and a variety of charitable foundations each own "an interest in . . . proved reserves." Who their "affiliates" may be under the Bill and whether their aggregate interest is "in" ten million barrels or more are questions which are presently without answer. Notwithstanding the fact that none of them is an intended target of the Bill, each of these entities may be placed in jeopardy by it.

So also are those entities, like Panhandle Eastern Pipe Line Company, which provide natural gas service to American homes and businesses. Our pipelines could not continue, over the long term, to serve the needs of our market area adequately if, intentionally or otherwise, the operation of S2362 should preclude us from extending or improving our pipeline system across Federal lands. On the other hand, we could not stop doing business during the period specified by the Bill, should it be adopted, or avoid every routine situation which its extraordinarily broad sweep encompasses. Necessarily, then the enactment of this measure would place our natural gas service, and those who depend on it, at great risk.

Business combinations are already subject to extensive state and Federal controls developed over decades of enforcement experience. We do not believe that any further controls are necessary.

If we are to have controls, their effect should be confined to combinations deemed disruptive to the common good. In our opinion, S2362 does not pass this test. Instead, in sweeping and vague terms, it encompasses and penalizes a vast array of routine business transactions which are, and will continue to be, entirely legal in themselves. We believe, therefore, that S2363 should not receive favorable consideration.

○